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Case No. \_\_\_\_\_

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## In the Supreme Court of the United States

October Term, 1982

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THE CLEVELAND ELECTRIC ILLUMINATING  
COMPANY,

*Appellant,*

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,

*Appellee.*

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ON APPEAL FROM THE SUPREME COURT OF OHIO

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### APPENDIX

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## TABLE OF CONTENTS OF APPENDIX

	<u>PAGE</u>
Appellant's Notice of Appeal To The Supreme Court of The United States (filed July 7, 1983) .....	3
<i>Dayton Power &amp; Light Co. v. Pub. Util. Comm.</i> , 4 Ohio St. 3d 91, 447 N.E. 2d 733 (1983) .....	5
<i>Cleveland Electric Illuminating Co. v. Pub. Util. Comm.</i> , 4 Ohio St. 3d 107, 447 N.E. 2d 746 (1983) .....	33
<i>Consumers' Counsel v. Pub. Util. Comm. (CEI)</i> , 4 Ohio St. 3d 111, 447 N.E. 2d 749 (1983) .....	39
<i>Opinion and Order</i> of the Public Utilities Commission of Ohio in Case No. 81-1378-EL-AIR (filed January 5, 1983) .....	51
<i>Rehearing Entry</i> of The Public Utilities Commission of Ohio in Case No. 81-146-EL-AIR (filed May 12, 1982) .....	160
<i>Opinion and Order</i> of the Public Utilities Commission of Ohio in Case No. 81-146-EL-AIR (filed March 12, 1982) .....	168
Journal Entry of Ohio Supreme Court Denying Rehear- ing in Case No. 82-165 (filed July 29, 1982) .....	258
Journal Entry and Mandate of Ohio Supreme Court Dismissing Appeal in Case No. 82-165 (filed July 7, 1982) .....	259
<i>Entry on Rehearing</i> of the Public Utilities Commission of Ohio in Case No. 81-1096-EL-COI (filed December 9, 1981) .....	261
<i>Opinion and Order</i> of the Public Utilities Commission of Ohio in Case No. 81-1096-EL-COI (filed October 21, 1981) .....	264
Journal Entry of Ohio Supreme Court Denying Motion for Stay in Case No. 80-1480 (filed September 11, 1981) .....	272

	<u>PAGE</u>
Journal Entries of Ohio Supreme Court Denying Rehearing in Case Nos. 80-1547, 80-1528, and 80-1480 (filed September 1, 1981) .....	273
<i>Consumers' Counsel v. Pub. Util. Comm. (CEI)</i> , 67 Ohio St.2d 153, 423 N.E. 2d 820 (1981) .....	276
<i>Rehearing Entry</i> of the Public Utilities Commission in Case No. 79-537-EL-AIR (filed September 3, 1980) .....	300
<i>Opinion and Order</i> in Case No. 79-537-EL-AIR of the Public Utilities Commission of Ohio (filed July 10, 1980) .....	308
<i>Order On Motions For Summary Disposition</i> , in Docket No. ER 81-612-000 of the Federal Energy Regulatory Commission (filed April 14, 1982) .....	400
Letter of Federal Energy Regulatory Commission Staff directing immediate write-off (dated July 7, 1982) .....	419
Ohio Statutes: Ohio Revised Code §§ 4905.13, 4905.18, 4905.20, 4905.22, 4909.15; Ohio Administrative Code § 4901:1-9-05 .....	422

**FILED**  
**JULY 7 1983**  
**SUPREME COURT OF OHIO**  
JAMES WM. KELLY, Clerk

**IN THE SUPREME COURT OF OHIO**

**CASE NO. 82-989**

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THE CLEVELAND ELECTRIC  
ILLUMINATING COMPANY,  
*Appellant,*

v.

THE PUBLIC UTILITIES COMMISSION OF OHIO,  
*Appellee.*

---

Appeal From the Public Utilities Commission of Ohio  
Case No. 81-146-EL-AIR

In the Matter of the Application of  
The Cleveland Electric Illuminating Company  
for Authority to Increase Its Filed Schedules  
Fixing Rates and Charges for Electric Service

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**NOTICE OF APPEAL  
TO THE SUPREME COURT  
OF THE UNITED STATES**

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**IN THE SUPREME COURT OF OHIO**

**CASE NO. 82-989**

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**THE CLEVELAND ELECTRIC  
ILLUMINATING COMPANY,**

*Appellant,*

**v.**

**THE PUBLIC UTILITIES COMMISSION OF OHIO,**  
*Appellee.*

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**Appeal From the Public Utilities Commission of Ohio  
Case No. 81-146-EL-AIR**

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**NOTICE OF APPEAL  
TO THE SUPREME COURT  
OF THE UNITED STATES**

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Notice is hereby given that The Cleveland Electric Illuminating Company, Appellant before the Ohio Supreme Court, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Ohio entered into these proceedings on April 13, 1983 affirming the March 17, 1982 Opinion and Order of the Public Utilities Commission of Ohio in Case No. 81-146-EL-AIR.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

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**CERTIFICATE OF SERVICE**

I hereby certify that true copies of the foregoing Notice of Appeal were served on all parties of record by United States Mail, first-class, postage prepaid, to their last known addresses, this 7th day of July, 1983.

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**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

**DECISION AND OPINION OF  
 THE SUPREME COURT OF OHIO**

**DAYTON POWER & LIGHT COMPANY, APPELLANT, v.  
 PUBLIC UTILITIES COMMISSION OF OHIO ET AL., APPELLEES.**

*Public Utilities Commission: post-test-year wage adjustment disapproved, when; increased excise tax levy imposed by Am. S. B. No. 448 is a recoverable "normal" expense, when, R. C. 4909.161; Fifth and Fourteenth Amendments not violated by denial of utility's request to treat expenditures associated with cancelled generating plant as amortizable costs, R. C. 4909.15 (A)(4).*

1. Payment of any type of increased excise tax levy after November 15, 1981 shall be considered to be a normal expense incurred by a public utility in the course of rendering service to the public. (R. C. 4909.161, construed).
2. The Public Utilities Commission's disallowance of a utility's request to treat its expenditures associated with a cancelled generating plant as amortizable costs pursuant to R. C. 4909.15(A)(4) does not violate the Fifth and Fourteenth Amendments to the Constitution of the United States.

(No. 82-526 — Decided  
 April 13, 1983.)

APPEAL from the Public Utilities Commission of Ohio.

[92] This appeal is taken from an order of the Public Utilities Commission of Ohio (hereinafter "commission") granting appellant, the Dayton Power & Light Company (hereinafter "DP&L"), a rate increase in case No. 81-21-EL-AIR. DP&L filed its application to increase rates for

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

electric service with the commission on April 4, 1981. The commission designated the period beginning October 1, 1980 and ending September 30, 1981 as the statutory test period and set March 31, 1981 as the date certain. After public hearings were held, the commission issued an order on February 3, 1982. The order *inter alia* denied DP&L's requests (1) to include a post-test-year wage adjustment, (2) to allow recovery for installment payments of a one percent gross receipts tax payable after the test year, and (3) to amortize its investment in a cancelled power plant. DP&L applied for a rehearing on the aforementioned issues, which the commission denied.<sup>1</sup>

On November 20, 1979, DP&L and the Utility Workers of America entered into an agreement providing for a 7.48 percent wage increase effective October 25, 1981, approximately one month after the designated test year ended. Appellant sought to adjust the hourly wage rate to be used in calculating its cost of service to reflect the October 25, 1981 wage increase. The proposed adjustment would have raised the average hourly wage rate from \$9.76 to \$10.3194. The commission denied this adjustment on authority of *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 372 [21 O.O. 3d 234].

Appellant also requested an adjustment to allow the full recovery of tax payments made pursuant to Am. S. B. No. 448, which imposed a temporary one percent gross receipts tax on utility companies effective January 1, 1981. The commission had allowed recognition of the one percent gross receipts tax in DP&L's most recent prior rate case, case No. 80-687-EL-AIR, but the rates established in that

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<sup>1</sup>The commission did grant a limited rehearing in connection with changes in the treatment of investment tax credits prompted by the Economic Recovery Tax Act of 1981. This matter is not, however, before this court.

**Dayton Power & Light Co. v. Pub. Util. Comm.  
4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

case were not in effect long enough to allow DP&L to recover the total amount paid pursuant to Am. S. B. No. 448. In its order the commission overrode its staff's recommendation<sup>2</sup> and denied rate recognition for the balance of one percent temporary tax payments, distinguishing the instant case from case No. 80-687-EL-AIR for the following reasons:

"In applicant's prior case, as in those other rate proceedings wherein we approved an allowance for the temporary one percent increase in the gross receipts tax, rate recognition of the increase was clearly required in the rates authorized were to reflect the cost of providing service during the period the rates were to be in effect \*\*\*. However, the same factors are not at work here, for although the temporary increase was in effect during the test period [93] and a payment at the increased rate was made subsequent to the test period, the obligation to pay the tax at the increased rate has now terminated \*\*\*. As we have held on so many occasions as to make citation unnecessary, it is not the Commission's function to provide for dollar-for-dollar recovery of specific past expenses, but to provide a reasonable future earnings opportunity. Accordingly, there should be no allowance in this proceeding for the temporary one percent increase in gross receipts tax imposed by Am. Senate Bill No. 448."

In its application for rehearing DP&L argued that the enactment of R. C. 4909.161, effective November 15, 1981, mandated full recovery of the tax payments in question. The commission declined to modify its order, finding that "the cited statute [R. C. 4909.161] does provide for recov-

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<sup>2</sup>The staff recommended "that full recovery be allowed but that applicant [appellant] be required to file tariffs containing reduced rates upon full recovery of the one percent increase."

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

ery of certain excise tax increases; but we think it apparent that the legislation cannot logically be interpreted to permit recovery of a tax increase which had expired long before the rates set in this case became effective."

Appellant's application proposed an adjustment providing for the amortization of \$4,796,000 in expenditures associated with the cancellation of construction of the Killen Generating Station Unit 1 (hereinafter "Killen"). The commission denied the amortization, citing *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153 [21 O.O. 3d 96].

The Office of Consumers' Counsel (hereinafter "OCC") has been granted leave to intervene as an appellee.

The cause is now before this court upon an appeal as of right.

*Mr. Stephen F. Koziar, Jr., Smith & Schnacke Co., L.P.A., Mr. Charles J. Faruki, Mr. Paul L. Horstman and Mr. D. Jeffrey Ireland, for appellant.*

*Mr. William J. Brown, attorney general, Mr. Marvin I. Resnik and Mr. Donn D. Rosenblum, for appellee.*

*Mr. William A. Spratley, consumers' counsel, Mr. Timothy C. Jochim and Ms. Janine L. Migden, for intervening appellee.*

SWEENEY, J. This appeal presents three issues for review. The first is whether the commission erred in disapproving appellant's proposed post-test-year wage adjustment. The second is whether the commission properly denied recovery of the increased excise tax levy imposed by Am. S. B. No. 448. The third is whether the exclusion of the Killen expenditures pursuant to R. C. 4909.15(A) (4) amounts to the confiscation of appellant's property in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

Before proceeding further, we note that "[t]he scope of this court's review of commission orders is set forth in R. C. 4903.13, which states in pertinent part:

" "A final order made by the public utilities commission shall be reversed, vacated, or modified by the supreme court on appeal, if, upon consideration of the record, such court is of the opinion that such order was unlawful or unreasonable."

[94] " "Under the 'unlawful or unreasonable' standard specified in R. C. 4903.13, this court will not reverse or modify an opinion and order of the Public Utilities Commission where the record contains sufficient probative evidence to show that the commission's determination is not manifestly against the weight of the evidence and is not so clearly unsupported by the record as to show misapprehension, mistake or willful disregard of duty," *Columbus v. Pub. Util. Comm.* (1979), 58 Ohio St. 2nd 103, 104 [12 O.O. 3d 112]. See also, *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 108, 110 [12 O.O. 3d 115]; *Ohio Utilities Co. v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 153, 164 [12 O.O. 3d 167]; *Duff v. Pub. Util. Comm.* (1978), 56 Ohio St. 2d 367, 370 [10 O.O. 3d 493]; *General Motors Corp. v. Pub. Util. Comm.* (1976), 47 Ohio St. 2d 58 [1 O.O. 3d 35], paragraph two of the syllabus; *Cleveland Electric Illuminating Co. v. Pub. Util. Comm.* (1975), 42 Ohio St. 2d 403 [71 O.O. 2d 393], paragraph eight of the syllabus. We assess the appellant[s] objections with this standard of review in mind.' *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153, 155-156 [21 O.O. 3d 96]." *Armco, Inc. v. Pub. Util. Comm.* (1982), 69 Ohio St. 2d 401, 404-405 [21 O.O. 3d 361].

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

**I**

The issue of post-test-year wage adjustments has twice been before us recently. In *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 372 [21 O.O. 3d 234] (hereinafter "*EOG*") this court reversed an order of the commission granting the East Ohio Gas Company a 9.4 percent wage annualization to reflect an increase in wage rates, which increase went into effect after the designated test year had ended. After reprising the applicable statutes, R. C. 4909.15 (A)(4), 4909.15(C), and 4909.15(D)(2)(b), we determined in *EOG* that the labor adjustment granted by the commission did not represent the type of anomalous condition for which inclusion of costs not incurred during the test period would be permissible.<sup>3</sup> As we noted in *EOG*, *supra*, at page 374, the General Assembly has expressly endorsed the test-year methodology:

"The language of R. C. 4909.15 is unequivocal. Rate increases are based on costs of rendering utility service *during the test period*. The dates of the test year follow directly from the date the utility chooses to file for its rate increase. Aware that its employee labor contract was about to be renegotiated, the utility company filed the application with the commission at a time which caused the test year to end prior to the beginning date of the new contract. The adjustment which *EOG* sought on rehearing to take into account its increased labor costs arising from that contract would violate the test-year concept embodied in R. C. 4909.15." (Emphasis *sic*.)

Appellant seeks to distinguish *EOG* on its facts and argues in its first [95] proposition of law that "[a] utility's

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<sup>3</sup>Compare *EOG* with *Bd. of Commrs. v. Pub. Util. Comm.* [1982], 1 Ohio St. 3d 125 (post-test-year adjustment for line clearance allowed.)

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

labor expense, as determined under Rev. Code § 4909.15 (A)(4), includes a known and measurable increase in wage rates pursuant to a contract negotiated and executed prior to the end of the test period." The significance that appellant attributes to the fact that it had already committed itself to the subject wage agreement while the new wage package in *EOG* had not been negotiated prior to the end of the test period is unwarranted. In the second case previously alluded to involving post-test-year wage adjustments, *Ohio Water Service Co. v. Pub. Util. Comm.* (1983), 3 Ohio St. 3d 1, we were presented with facts virtually identical to those presented herein. Ohio Water Service's wage agreement with its employees had been negotiated and the obligations had become fixed prior to the test year. The disputed wage increase in *Ohio Water Service* went into effect one day after the test period ended. Relying on our analysis in *EOG*, we held that the commission did not err in excluding the post-test-year wage adjustment. The same rationale applies to the case at bar. Thus, while we acknowledged in *EOG* and *Ohio Water Service* that the test-year data are not immutable and have upheld appropriate exceptions in previous cases,<sup>4</sup> exceptions must remain exceptions, and *ad hoc* tinkering with the statutory formula is not to become the rule. We recognized as much in *Consumer's Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153 [21 O.O. 3d 96] (hereinafter "*CEI*"), in discussing the exceptions language contained in R. C. 4909.15(D)(2)(b), where we stated, at page 165, that "\*\*\* the General Assembly undoubtedly did not intend to build into its recently revised (1976) ratemaking formula a means by which the commission may effortlessly abrogate that very formula."

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<sup>4</sup>See, e.g., *Bd. of Commrs., supra*, fn. 3.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

Moreover, the commission itself came to a similar conclusion regarding test-period data under the revised rate-making formula when it expressed doubt in a previous DP&L case, case No. 76-88-GA-AIR, as to whether it could continue its former practice of routinely permitting adjustments for known and measurable post-test-year cost changes. The commission stated, at page 6 of its opinion: " \*\*\* Although the argument for post-test-year adjustments of this nature [l]oses force when dealing with much more current test years<sup>5</sup> and although the practice may be prohibited by Section 4909.15(C) Revised Code, the principle [annualization of certain costs at levels existing at the end of the test year] remains controlling with respect to cost changes which occur within the test period." *EOG, Ohio Water Service*, and now the case at bar simply confirm what the commission surmised in 1976 with respect to the General Assembly's intentional circumscription of the commission's authority to grant the type of post-test-year adjustment requested by appellant in its application. As one commentator has noted, " \*\*\* adjusting only for selected changes is repugnant to the test year's theoretical roots — its usefulness is capturing for simultaneous [96] observation the dynamic interrelationship among revenue, expenses and investment." \* Note, *The Use of the Future*

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<sup>5</sup>The commission's recognition of "much more current test years" is borne out in the instant case as appellant filed a notice of intent to apply for a rate increase in October 1981 with another planned for mid-1982.

<sup>6</sup>OCC witness Miller expressed this view, stating that " \*\*\* [selectivity] is the problem I have with the whole annualization procedure. It's not so much that I disagree with the fact that some figures may not be more properly adjusted, but all things should be looked at and adjusted has been my problem." See, generally, Catalant, *Rate Making in an Inflationary Context: Theories and Applications*, 110 Pub. Util. Fort., April 15, 1982, at page 53.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

Test Year in Utility Ratemaking (1972), 52 Boston U. L. Rev. 791, 796. Accordingly, appellant's contention that R. C. 4909.15 mandates inclusion of the post-test-year wage adjustment is without merit.<sup>7</sup>

## II

Appellant asserts in its second proposition of law that "Revised Code § 4909.161 mandates that the public utilities commission approve rate schedules which will permit a public utility to fully recover in its rates the increased excise tax levy resulting from the 1% additional gross receipts tax imposed by Am. Senate Bill N. 448." As previously noted, the commission disallowed recovery of DP&L's tax payments made pursuant to Am. S. B. No. 448 that had not been recovered under the rates established in case No. 80-687-EL-AIR. Am. S. B. No. 448, which imposed an additional one percent tax on gross receipts, became effective on January 1, 1981 and expired June 30, 1981. Appellant paid the increased tax levy in four installments in January, March, June, and December 1981. The first three installment payments were made within the test year but prior to the November 15, 1981 effective date of R. C. 4909.161. The December payment was made outside the test period but after R. C. 4909.161 took effect. The commission acknowledged R. C. 4909.161 in denying rehearing

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<sup>7</sup>Appellant also asserts that "••• [t]he rates established ••• without recognition of the known and measurable wage increase are unreasonable and confiscatory," but offers little to support the contention. The record does contain exhibits comparing the actual payroll expenses for September 1981 (\$7,255,717) and November 1981 (\$7,183,568), but appellant does not refer to these or any other calculations in making the argument that denial of the post-test-year wage adjustment is somehow confiscatory. Based on these figures, moreover, it would be difficult for appellant to argue unrepresentativeness, much less, confiscation.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

but declined to make the adjustment sought by DP&L for the reason "that the legislation cannot logically be interpreted to permit recovery of a tax increase which had expired long before the rates set in this case became effective." While we find no fault with the commission's logic, we are compelled to disagree with its reading of R. C. 4909.161, at least insofar as the commission denied recovery of the December payment or any portion thereof not previously recovered.

R. C. 4909.161 states as follows:

"Notwithstanding the provisions of Chapters 4905. and 4909. of the Revised Code, the payment of any type of increased excise tax levy shall be considered to be a normal expense incurred by a public utility in the course of rendering service to the public, and may be recovered as such in accordance with an order of the public utilities commission. Any public utility required to [97] pay any such increased excise tax levy may file with the public utilities commission revised rate schedules which will permit full recovery on an interim or permanent basis in its rates, of the amount of any resultant increased tax payments and the commission shall promptly act to approve such schedules."

The statute sets forth the broad rule that "the payment of any type of increased tax levy shall be considered to be a normal expense.\* \* \*" This provision is keyed to "payment" of a tax irrespective of whether the tax upon which the payment has been made remains in effect or has expired. Ordinarily the commission would be empowered to deny recovery for an anomalous expense and, indeed, we do not disturb the commission's disallowance of the unrecovered portions attributable to the January, March and June 1981 installments paid on the temporary one percent gross receipts tax. The General Assembly's

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

enactment of R. C. 4909.161 has, however, established as a matter of law that payment of any type of increased excise tax levy after November 15, 1981 shall be considered to be a normal expense incurred by a public utility in the course of rendering service to the public. Thus, the commission erred in disregarding the plain language and import of R. C. 4909.161 when it denied recovery of the December installment payment (or the unrecovered balance thereof) in the current case.

The record does not reflect the precise amounts of the installments paid pursuant to Am. S. B. No. 448 or the amount of the tax that has been recovered pursuant to the rates set in DP&L's previous rate case. We find it necessary, therefore, to reverse and remand the cause to the commission for further proceedings to determine (1) the amount of the installment paid in December, the full recovery of which is mandated by R. C. 4909.161, and (2) to prevent a possible over-recovery, the amount, if any, of monies previously recovered under the rates set in case No. 80-687-EL-AIR attributable to the December installment. Upon making these determinations, the commission shall modify its order so as to allow appellant to recover the difference between the December one percent excise tax payment and any monies already recovered thereon.

### III

#### A

In its final proposition of law appellant challenges the constitutionality of the commission's disallowance of DP&L's request to treat its investment in the cancelled Killen facility as amortizable costs. Before proceeding to appellant's specific contentions regarding Killen, it is appropriate for us to review the historical development

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

underlying current federal constitutional doctrine respecting utility ratemaking.

The leading federal constitutional cases involving claims of confiscatory utility rate orders establish two fundamental precepts. The first is that "\*\*\* he who would upset the rate order \*\*\* carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *FPC v. Hope Natural Gas Co.* (1944), 320 U.S. 591, 602 [98] See, also, *Permian Basin Area Rate Cases* (1968), 390 U. S. 747, 767. The second precept is that a challenged rate order must be "viewed in its entirety," *FPC v. Natural Gas Pipeline Co.* (1942), 315 U. S. 575, 586; *Hope Natural Gas Co.*, *supra*, at page 602, to determine whether the rates set pursuant to the order fall within "the broad zone of reasonableness." *Permian Basin Area Rate Cases*, *supra*, at page 770.<sup>8</sup>

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<sup>8</sup>A third important precept to be drawn from the federal cases, that "[t]he Constitution does not bind rate-making bodies to the service of any single formula or a combination of formulas," *Natural Gas Pipeline Co.*, *supra*, at page 586; *Hope Natural Gas Co.*, *supra*, at page 600; *Permian Basin Area Rate Cases*, *supra*, at page 800, need not concern us because the General Assembly has prescribed a statutory ratemaking formula for the commission to follow in contradistinction to the broad grant of authority delegated by Congress to the Federal Power Commission (and now FERC) to establish rates under the Natural Gas Act as amended, Sections 717 *et seq.*, Title 15, U. S. Code.

Accordingly, it is unnecessary to reprise the constitutional formula based on the rule of *Smyth v. Ames* (1898), 169 U. S. 466, 547 ("fair return upon \*\*\* value"), the controversy engendered by *Smyth* during the years of its ascendancy, see, e.g., *Missouri, ex rel. Southwestern Bell Tel. Co., v. Pub. Serv. Comm.* (1923), 262 U. S. 276, 289 (Brandeis, J., concurring), or the prudent investment theory proposed by Justice Brandeis in *Southwestern Bell* to supplant *Smyth* and provide a more workable mode of constitutional analysis.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

The historical background from which these precepts developed was summarized by Justice Black in his dissenting opinion in *McCart v. Indianapolis Water Co.* (1938), 302 U. S. 419, 427-428:

"For the first hundred years of this Nation's history, federal courts did not interfere with state legislation fixing maximum rates for public services performed within the respective states. The state legislatures, according to a custom which this Court declared had existed 'from time immemorial' decided what those maximum rates should be. This Court also said that 'for protection against abuses by legislatures the people must resort to the polls, not to the courts.' It was not until 1890 that a dividend court [in *Chicago, M & St. P. Ry. Co. v. Minnesota* (1890), 134 U. S. 418] finally repudiated its earlier constitutional interpretation and declared that due process of law requires judicial invalidation of legislative rates which the courts believe confiscatory. The dissenting Justices adhered to the long existing principle that regulation of public utilities was a 'legislative prerogative and not a judicial one.'" (Footnotes omitted.)

In *Natural Gas Pipeline Co.*, *supra*, Justice Black expanded upon his *McCart* history lesson in a concurring opinion joined by Justices Douglas and Murphy where he once again expressed his deep disagreement with the notion that "'due process' means no less than 'reasonableness judicially determined' \*\*\* which, in the words of Justice Holmes, makes the sky the limit of judicial power to declare legislative acts unconstitutional, the conclusions of judges, substituted for those of legislatures, become a broad and varying standard of constitutionality." 315 U.S., at page 600. Justice Frankfurter, concurring separately, took issue with Justice Black's historical exegesis, stating, at page 609, that "[w]hile the doctrine of 'confiscation,'

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

as a limitation to be enforced by the judiciary upon the legislative power to fix utility [99] rates, was first applied in *Chicago, M & St. P. Ry. Co. v. Minnesota*, 134 U.S. 418, that decision followed principles, expounded in *Stone v. Farmers' Loan & Trust Co.*, 116 U. S. 307, especially at 331. \*\*\* Mr. Chief Justice Waite, who delivered the opinion in the *Stone* case as well as in the earlier decision in *Munn v. Illinois*, 94 U. S. 113, was therefore the author of the doctrine of 'confiscation' and its corollary, 'judicial review.' His view was shared by such stout respecters of legislative power over utilities as Mr. Justice Miller \*\*\* Mr. Justice Bradley \*\*\* and Mr. Justice Harlan. The latter, indeed, agreed with Mr. Justice Field that the regulatory power exercised in the *Railroad Commission Cases*, 116 U. S. 307, constituted an impairment of the obligation of contract. By no one was the doctrine of judicial review more emphatically accepted, and applied in favor of a public utility, than by Mr. Justice Harlan in the decision and opinion in *Covington & Lexington Turnpike Co. v. Sandford*, 164 U. S. 578, especially at 591-95."

While we are not here concerned with whether Justice Black or Justice Frankfurter was more faithful to the muse of history, we do find it significant that Justice Frankfurter did not take exception to Justice Black's characterization of *Natural Gas Pipeline Co.* as "\*\*\*\* a new chapter in the regulation of utility rates \*\*\* [which] erases much which has been written in rate cases during the last half century \*\*\*." *Id.*, at page 602. The majority opinion in the 1944 *Hope Natural Gas Co.* case essentially adopted the theory of legislative hegemony in the sphere of economic regulation expressed in the *Natural Gas Pipeline Co.* concurrence. The court stated, at page 601, "that the 'authority of Congress to regulate the prices of commodities in interstate commerce is at least as great under

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

the Fifth Amendment as is that of the States under the Fourteenth to regulate the prices of commodities in intra-state commerce.' 315 U. S. p. 582. Ratemaking is indeed but one species of price fixing. *Munn v. Illinois*, 94 U. S. 113, 134. The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean the regulation is invalid."

In *Permian Basin Area Rate Cases*, *supra*, the court deferred to the legislative will as expressed by Congress administrative surrogate, the Federal Power Commission, so completely that Justice Douglas, the author of the *Hope Natural Gas Co.* opinion, was compelled to dissent in an ironic turnabout. 390 U. S., at pages 829-845. In the words of one commentator, "with the *Permian* decision the Court has completed a long circle back to almost where it started in *Mun v. Illinois* (1876), 94 U. S. 113] 92 years previous. The Constitution no longer provides any special protection for the utility investor. Regulation is deemed no different from any other governmental action; it can 'limit stringently' the profitability of his investment in endeavoring to balance the 'broad public interest entrusted to its protection.'" Bernstein, *Utility Rate Regulation: The Little Locomotive That Couldn't* (1970), Wash. U.L.Q. 223, 259-260. Although utility companies continue to appeal allegedly confiscatory rate orders that state courts have [100] upheld as constitutional, the United States Supreme Court in recent years has been disinclined to hear these appeals and has dismissed them summarily either for want of a substantial federal question, see, e.g., *Appalachian Power Co. v. West Virginia Pub. Service Comm.* (W. Va. Oct. 10, 1977), unreported, appeal dismissed (1978), 435 U. S. 901; *South Central Bell Tel. Co. v. Louisiana Pub. Serv. Comm.* (La. 1977),

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

352 So. 2nd 964, appeals dismissed (1978), 437 U. S. 911; *California Assn. Of Utility Shareholders v. California Pub. Util. Comm.* (Cal. July 19, 1979), unreported, appeal dismissed (1979), 444 U. S. 986; *C & SOE v. Pub. Util. Comm.* (1980), 64 Ohio St. 2d 175 [18 O.O. 3d 389], appeal dismissed (1981), 452 U. S. 933; or for want of a properly presented federal question, see *CEI, supra* (67 Ohio St. 2d 153 [21 O.O. 3d 96]), appeal dismissed (1982), \_\_\_\_\_ U. S. \_\_\_\_\_, 71 L. Ed. 2d 455, appeal dismissed (Jan. 11, 1983), 51 U.S.L.W. 3507. The high court's summary dispositions of the aforementioned appeals at the least suggest that the court has implicitly recognized the commentator's conclusion that "the Constitution no longer provides any special protection for the utility investor." It is against this federal constitutional backdrop that we now view appellant's specific contentions regarding the disallowed Killen expenditures.

### III

#### B

Appellant contends that "[a]n interpretation of Rev. Code § 4909.15(A)(4) which excludes from a utility's cost of service the accumulated costs associated with the cancellation of a planned generating facility is unconstitutional as applied to that utility, and violates the Fifth Amendment applied to the Federal Constitution."<sup>9</sup> Specifically, DP&L argues that denying recovery of the Killen expenditures amounts to the confiscation of its property and urges us to overturn our decision in *CEI*.

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<sup>9</sup>The confiscation clause of the Fifth Amendment applies to the states through the Due Process Clause of the Fourteenth Amendment. See *Webb's Fabulous Pharmacies, Inc. v. Beckwith* (1980), 449 U. S. 155.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

In *CEI*, *supra*, we held in the syllabus that "[t]he Public Utilities Commission's treatment of a utility's investment in terminated nuclear generation stations as amortizable costs to be recovered from the utility's rate-payers is inconsistent with the ratemaking formula contained in R. C. 4909.15 and is unreasonable and unlawful." Several of the constitutional arguments advanced by appellant are similar to the statutory arguments that we considered and rejected in *CEI*. For example, appellant would rely on R. C. 4905.22 to support its contention that Killen expenditures "were incurred in order to provide necessary and adequate service."<sup>10</sup> The commis- [101] sion in *CEI* phrased its argument in virtually identical terms. We addressed this argument, at pages 163-164, stating as follows:

"The commission urges that 'an expenditure by a utility can be considered a cost of rendering the public utility service if it fails in fact to achieve its intended purpose \*\*\* [if] the expense was reasonably calculated to provide [future] utility service at a reasonable cost.' The underpinnings for the commission rationale may be found in those statutory provisions that require utilities to maintain adequate service presently and for the foreseeable future. See, *e.g.*, R. C. 4905.22 (adequate service and facilities).

"Notwithstanding the provisions that impose a duty on utility companies to plan for the future, the question under R. C. 4909.15(A)(4) remains whether the cancelled plant expenditures represent '[t]he cost to the utility of

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<sup>10</sup>R. C. 4905.22 provides in pertinent part:

"Every public utility shall furnish necessary and adequate service and facilities, and every public utility shall furnish and provide with respect to its business such instrumentalities and facilities, as are adequate and in all respects just and reasonable. \*\*\*"

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

rendering the public utility service for the test period.' Test period considerations aside, what the company sought and what the commission granted was the amortization as service-related costs of an investment that never provided any service whatsoever to the utility's customers.<sup>11</sup>

“... The now terminated nuclear plants represented a major capital investment that ultimately would have been included in the rate base under R. C. 4909.15(A)(1), had the projects not been cancelled. It is our opinion that R. C. 4909.15(A)(4) is designed to take into account the normal, recurring expenses incurred by utilities in the course of rendering service to the public for the test period. ...”

“The extraordinary loss sustained by CEI in connection with the terminated nuclear plants cannot be trans-

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<sup>11</sup>Cf. *West Ohio Gas Co. v. Pub. Util. Comm.* (1935), 294 U. S. 63, 78 (Stone, J., concurring):

“...The property for which constitutional protection is invoked is that ‘used and useful in the public service,’ not the enlarged business of the future which petitioner hopes to obtain through the present expenditure of money. I know of no constitutional principle upon which this expenditure must be taken from the pockets of the patrons of the present business, any more than the cost of future service lines required to carry on the new business. ...”

Although Justice Stone made the above-quoted statement to express his disagreement with the expansive constitutional protection afforded “prudent outlay” by his brethren, his narrower conception of that which the constitution protects became the majority position in *Natural Gas Pipeline Co.*, an opinion delivered by Chief Justice Stone. Moreover, Justice Stone joined the *Hope Natural Gas Co.*, majority, which delimited the constitutional inquiry even further by deleting the references to “constitutional requirements” and “the limits of due process” that the concurring justices in *Natural Gas Pipeline Co.* found objectionable.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

formed into an ordinary operating expense pursuant to R. C. 4909.15(A)(4) by commission fiat. The commission's statement that '[c]ancellation does not create a past loss, but gives rise to a current cost' is unpersuasive. Under this rationale we question whether there could ever be a 'past loss' the return of which would not be recoverable in future ratemaking proceedings notwithstanding the commission's assertion to the contrary. \*\*\*"

Appellant further contends that the commission, in denying the Killen amortization on the strength of this court's decision in *CEI*, disregarded the constitutional requirement announced in *FPC v. Hope Natural Gas Co.*, [102] *supra* (320 U. S. 591), at page 603, that "[t]he rate-making process \*\*\* involves a balancing of the investor and the consumer interest." Appellant asserts that it "and all Ohio utilities are disadvantaged in the capital markets where they must attract capital in order to plan for the future and to provide adequate facilities under Rev. Code § 4905.22 because the utilities must inform their investors that they may not be permitted to earn a rate of return on this investment if the facilities which are prudently planned and necessary today are cancelled in the future."

This same argument was presented under the rubric of "policy" in *CEI* where we stated, at pages 167-168:

"We are mindful of the policy considerations that prompted the commission's decision. The commission, *CEI*, and the *amici* argue strenuously that to rule as we have today will seriously disadvantage Ohio utilities in capital markets thereby 'driv[ing] up the return on investment required by investors in Ohio utilities.' This gloomy scenario, however, does not imbue the commission with the authority to rewrite the statutes. The statutes in ques-

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

tion contain no provisions insulating investors from the type of losses sustained in the cancelled-plants venture.

"If, as has been argued, these are parlous times for the utilities industry, and if, therefore, in order to attract and retain investment capital, utility companies must not only be granted a fair and reasonable rate of return pursuant to statute but must also be assured the return of capital invested in failed projects that would otherwise not be recoverable under the ratemaking formula, then the commission and the utilities should petition the General Assembly to enact changes in the ratemaking structure so as to provide this extra modicum of protection for the investors. Absent such explicit statutory authorization, however, the commission may not benefit the investors by guaranteeing the full return of their capital at the expense of the ratepayers. Under the ratemaking formula now in effect consumers are not chargeable for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs. What we previously stated in a rate base case is applicable to the case at bar: "••• It is only proper that their [the investors'] venture be found operational before they commence to recoup their capital outlays from the consumers.' *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 449, 456-457 [12 O.O. 3d 378]."

In *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 449 [12 O.O. 3d 378] (hereinafter "*Toledo Edison*"), this court held that the Davis-Besse Unit 1 generating station, which was not "used and useful in rendering the public utility service" pursuant to R. C. 4909.15 (A)(1), could not be included in the utility's rate base. Toledo Edison made a constitutional argument similar to that presented herein to which we responded, at page 456:

**Dayton Power & Light Co. v. Pub. Util. Comm.,  
4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

"Toledo Edison argues that to deny inclusion of the unit in its rate base would be tantamount to the confiscation of its property in violation of its constitutional right to due process of law. In *Columbus Gas & Fuel Co. v. Pub. Util. Comm.*, *supra* (292 U. S. 398), the Supreme Court addressed the issue of [103] whether gas fields not yet in service should be included in the rate base. Justice Cardozo, speaking for the court, stated, at page 406:

"There will be no need in the computation of the rate base to include the \*\*\* value of fields not presently in use, unless the time for using them is so near that they may be said, at least by analogy, to have the quality of working capital. \*\*\* Postponement of \*\*\* profit until the state of imminent or present use is not an act of confiscation, but a legitimate exercise of legislative judgment."

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"It would be inequitable to prematurely shift the risk of plant failure from the utility's investors to the rate-payers by the inclusion in the rate base of highly complex and innovative technology which has not been proven to be reasonably free from significant design or construction defects. The initial risk of failure is appropriately borne by investors, who have undertaken the project and who will ultimately profit from its success."

While we again note that *Toledo Edison* involved rate base consideration under 4909.15(A)(1), as opposed to matters relating to cost of service under R. C. 4909.15(A)(4), the analogy is a fair one insofar as it indicates that the General Assembly has adopted a consistent position in balancing investor and consumer interests in utility ratemaking. Pursuant to the statutory ratemaking formula investors are issued a fair and reasonable return on prop-

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

erty that is determined to be used and useful, R. C. 4909.15 (A)(2), plus the return of costs incurred in rendering the public service, R. C. 4909.15(A)(4), while consumers may not be charged "for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs."<sup>12</sup> We see no constitutional infirmity in the balance thus struck by the General Assembly.

Appellant also presents an elaborate argument premised on the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts, 18 C.F.R., Part 101, which Ohio utilities are required to follow pursuant

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<sup>12</sup>Am. Sub. S. B. No. 378 as passed by the Senate included the following language, offered to amend R. C. 4909.154:

"In its establishment of just and reasonable rates for public utilities under section 4909.15 of the Revised Code, the public utilities commission shall allow any expenditures incurred in the provision of public utility services unless such expenditures are found by the commission to have resulted from imprudent management."

This proposed amendatory language was deleted by the House of Representatives and did not reappear in the final version of the bill. See Am. Sub. S. B. No. 378.

Although Section 7 of Am. Sub. S. B. No. 378 as passed by the Senate, stated that, "Section 4909.154 of the Revised Code, as amended in Section 1 of this act, is not intended to reverse *Consumers' Counsel v. Public Utilities Commission* (1981), 67 Ohio St. 2d 153 [21 O.O. 3d 96], with respect to those specific capital costs that were disallowed in that case," the "any expenditures" language of the amendment would have broadened the range of allowable expenses considerably. That the General Assembly chose not to enact this proposed provision is further evidence that our decision in *CEI* comports with the legislative intention underlying the ratemaking statutes.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

to Ohio [104] Adm. Code 4901:1-9-05,<sup>13</sup> to support inclusion of its Killen expenditures. We were treated to similar accounting-based contentions in *CEI* but found it unnecessary to discuss them in our opinion because as OCC notes, "it is *not* the Uniform System of Accounts which governs public utility ratemaking, but rather the Ohio Revised Code." (Emphasis *sic.*) Thus, the controlling factor for ratemaking purposes is not whether the Killen expenditures must be accounted for under Account 182, "extraordinary property losses," as appellant claims, or whether these expenditures should be assigned to Account No. 121, "nonutility property" or Account No. 426.5, "other deductions," as OCC suggests. While we have acknowledged the Uniform System of Accounts in previous opinions, see, *e.g.*, *Consumers' Counsel v. Pub. Util. Comm.*, *supra* (58 Ohio St. 2d 108 [12 O.O. 3d 115]), at page 112; *Toledo Edison, supra, fn.*, at pages 455-456, we have never held and do not hold today that accounting practice and

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<sup>13</sup>Ohio Adm. Code 4901:1-9-05 provides in pertinent part:

"The system of accounts and records, identified and designated as 'Uniform System of Accounts Prescribed for Public Utilities and Licensees, effective January 1, 1961,' as adopted by the Federal Power Commission, is adopted by this Commission effective as of January 1, 1961, for electric light companies operating within the State of Ohio which are subject to the jurisdiction of the Federal Power Commission except to the extent that the provisions of said Uniform System of Accounts are inconsistent in any way with the outstanding orders of this Commission pertaining to the accounting treatment to be followed with respect to emergency facilities and the Federal income tax results thereof and with respect to accelerated depreciation and the Federal income tax results thereof. This Commission reserves to itself the right to require the creation and maintenance of such additional accounts as may hereafter be prescribed, to cover the accounting procedure of such electric light companies operating in the State of Ohio. \*\*\*"

Dayton Power & Light Co. v. Pub. Util. Comm.  
4 Ohio St. 3d 91, 447 NE 2d 733 (1983)

the ratemaking provisions of the Revised Code are functionally equivalent.<sup>14</sup> We rejected *sub silentio* this line of argument based on the Uniform System of Accounts in CEI and expressly reject it in the case at bar.<sup>15</sup>

In its final argument appellant asserts that "[e]xclusion of the costs associated with the cancellation of Killen Unit No. 1 guarantees that DP&L will be unable to earn a fair and reasonable rate of return." There is little evidentiary support for this contention. As the commission stated in its order, DP&L "objected to the staff's reversal of the company's [proposed Killen] adjustment, but presented no witnesses relative to the subject and did [105] not address the matter on brief."<sup>16</sup> This failure to present evidence relating to Killen and the effect thereof on the rates set by the commission may perhaps be explained if, as it appears, appellant's position is that excluding the Killen expenditures is confiscatory as a matter of law. *Per se* confiscation in a utility rate case may exist as an abstract premise, but the constitutional cases make it clear that a

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<sup>14</sup>The commission acknowledged the distinction between accounting and ratemaking in its opinion dated March 17, 1982, in case Nos. 81-146-EL-AIR and 81-1565-EL-UNC, stating, at page 28, that "although we cannot allow an amortization allowance for ratemaking purposes, for book purposes the applicant is authorized to amortize the balances assignable to the terminated nuclear units over an appropriate period of time, not to exceed 15 years." See *Consumers' Counsel v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 111.

<sup>15</sup>Appellant's argument based on the Uniform System of Accounts is further flawed by its internal inconsistency. As OCC recognized, "[a]ppellant did not and cannot explain the contradiction between its apparent recognition that Account 182 covers 'extraordinary property losses' and its simultaneous claim that Account 182 relates to 'normal expenses.'"

<sup>16</sup>At oral argument appellant briefly mentioned Killen but presented no argument relating thereto, relying instead on its briefs.

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

successful challenge must demonstrate that the rate order when reviewed in its entirety falls outside the "broad zone of reasonableness," *Permian Basin Area Rate Cases*, *supra*, at page 770, and the "heavy burden" of establishing unreasonableness must be borne by the challenger. *Hope Natural Gas Co.*, *supra*, at page 602.

Appellant's expert testified that "the \*\*\* [CEI] ruling serves to increase the risk associated with common stock ownership of electric utilities in this state," but did not attempt to quantify this perceived additional risk. Moreover, there is nothing to suggest that the commission did not take this purportedly greater risk into account in its order.<sup>17</sup> In determining the cost of equity capital the commission concluded that 16.44 percent was a "reasonable estimate," even though 16.44 percent was in "the upper half of the \*\*\* [cost of capital] range \*\*\*." The commission selected this figure after finding "\*\*\*\* it imprudent to dampen any optimism that may exist in the investment community with respect to the possibility that this company may be emerging from its extended financial crisis by authorizing an unduly conservative equity earnings opportunity in this proceeding." The commission's rate of return summary stated that "[a]pplying a cost of equity

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<sup>17</sup>The commission order did not specifically refer to "the increase in investment risk resulting from the [CEI] decision," as did the order in case Nos. 81-146-EL-AIR and 81-1565-EL-UNC (at page 40), but it is quite clear that the commission is fully cognizant of CEI. Indeed, it is the commission's position that the instant appeal "concerns the definition of risks\*\*\* [and CEI] merely defined the economic risks and benefits under Ohio law. One of the risks is that investors, not consumers, will be required to pay for plants which will never provide service to ratepayers. This, of course, may make Ohio utilities' capital and debt less attractive to investors, but it does not make rates confiscatory."

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

of 16.44 percent to the equity component of the capital structure approved herein produces, when combined with the findings relative to long-term debt and preferred stock, a weighted cost of capital of 12.11 percent. The Commission is of the opinion that a rate of return of 12.11 percent is sufficient to provide applicant reasonable compensation for the electric service it renders customers affected by this application." It follows that if the 16.44 percent cost of equity component is within the upper half of the range, then the 12.11 percent rate of return is also within the upper range. Thus, even if appellant were correct in its assertion that the Killen exclusion precludes it from earning its authorized rate of return, there is nothing in the record to suggest that any reduced rate of return attributable to the Killen exclusion would not still be constitutional because "any rate selected from the broad [106] zone of reasonableness cannot properly be attacked as confiscatory." *Permian Basin Area Rate Cases*, *supra*, at page 770.

To prevail, appellant must prove not only the unreasonableness of the Killen exclusion but also the confiscatory effect this exclusion had on the rates established by the commission, viewing the rate order "in its entirety." *Hope Natural Gas Co.*, *supra*, at page 602. We are unprepared to say that appellant has carried this "heavy burden" in either respect. In *CEI* we held that a utility's investment in cancelled generating facilities could not be treated as amortizable costs to be recovered from the utility's ratepayers under the statutory ratemaking formula. Appellant's arguments in the instant case are but variations on the statutory and policy arguments we found wanting in *CEI*, and we find them no more appealing when attired in constitutional raiment. Moreover, even these unpersuasive constitutional contentions lose whatever force they might

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

have had in the absence of any showing that the commission's order "viewed in its entirety" is confiscatory. The rule is clear: "\*\*\* If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry \*\*\* is at an end." *Hope Natural Gas Co.*, *supra*, at page 602. The total effect of the commission's rate order cannot be said to be unjust and unreasonable and therefore our judicial inquiry is at an end. Accordingly, we hold that the commission's disallowance of DP&L's request to treat its Killen expenditures as amortizable costs pursuant to R. C. 4909.15(A)(4) does not violate the Fifth and Fourteenth Amendments to the Constitution of the United States.

For the reasons hereinbefore stated the decision of the commission is affirmed in part and reversed in part and the case is remanded to the commission for further proceedings consistent with this opinion.

*Judgment accordingly.*

CELEBREZZE, C.J., W. BROWN, C. BROWN and WILSON, J.J., concur.

LOCHER and HOLMES, J.J., concur in part and dissent in part.

WILSON, J., of the Second Appellant District, sitting by assignment.

LOCHER, J., concurring in part and dissenting in part. I concur in Parts I and III of the majority opinion. As to Part II, however, I dissent.

This court has traditionally upheld the test-year concept. Part I of the majority opinion, *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 372 [21 O.O. 3d 234], and *Ohio Water Service Co. v. Pub. Util. Comm.* (1983), 3 Ohio St. 3d 1, enhance that tradition. Nevertheless, the majority fails to recognize that the issue in Part

**Dayton Power & Light Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 91, 447 NE 2d 733 (1983)**

II is essentially the same as that in Part I: whether this court will reverse the decision of the Public Utilities Commission to exclude a post-test-year expense from consideration. Both *Consumers' Counsel*, *supra*, and *Ohio Water Service*, *supra*, lead to the same conclusion. We should affirm the decision of the Public Utilities Commission [107] because: (1) the requested expense was incurred after the test year, and (2) the utility decided when to file its rate case. See *Consumers' Counsel*, *supra*, at pages 374-376.

We should not apply or construe R. C. 4909.161. Nothing in that provision suggests that it was intended to supersede the test-year concept. Furthermore, its application may violate the constitutional prohibition against the retroactive application of statutes, see Section 28, Article II of the Ohio Constitution, and the statutory presumption in favor of prospective laws, see R. C. 1.48, because of R. C. 4909.161 became effective *after* the original tax liability accrued and *after* the test year.

Accordingly, I would affirm the decision of the Public Utilities Commission as to all three issues before this court.

HOLMES, J., concurring in part and dissenting in part. I agree with the majority's resolution of the second and third issues. However, with respect to the first issue, the denial of appellant's post-test-year wage adjustment, I dissent on the basis of my dissenting opinions in *Consumer's Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 372, 376 [21 O.O. 3d 234], and *Ohio Water Service Co. v. Pub. Util. Comm.* (1983), 3 Ohio St. 3d 1, 4.

Cleve. Elec. Illum. Co. v. Pub. Util. Comm.  
4 Ohio St. 3d 107, 447 NE 2d 746 (1983)

DECISION AND OPINION OF  
THE SUPREME COURT OF OHIO

CLEVELAND ELECTRIC ILLUMINATING COMPANY,  
APPELLANT, v.

PUBLIC UTILITIES COMMISSION OF OHIO ET AL.,  
APPELLEES

*Public Utilities Commission; expenditures associated with four terminated nuclear generating stations not amortizable, when; private property not unconstitutionally confiscated by R. C. 4909.15(A)(4); Commission's findings of fact adequate, when, R. C. 4903.09.*

(No. 82-989 — Decided April 13, 1983.)

APPEAL from the Public Utilities Commission of Ohio.

This is an appeal by the Cleveland Electric Illuminating Company (hereinafter "CEI" or "company") from an order of the Public Utilities Commission (hereinafter "commission") fixing the company's rates and charges for electric service.<sup>1</sup> CEI had proposed an adjustment providing for the amortization of expenditures associated with the cancellation of four nuclear [108] generating stations.<sup>2</sup> The commission denied the amortization, citing *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153 [21 O.O. 3d 96], wherein this court first considered the expenditures here under discussion.

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<sup>1</sup>The same order of the commission, case Nos. 81-146-EL-AIR and 81-1565-EL-UNC, decided March 17, 1982, is the subject of the appeal taken by the Office of Consumers' Counsel in case No. 82-1004, *Consumers' Counsel v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 111, decided this date.

<sup>2</sup>For a description of the facts leading up to the termination of the facilities in question, see *Consumers' Counsel*, *infra*, at page 154.

**Cleve. Elec. Illum. Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 107, 447 NE 2d 746 (1983)**

CEI sought rehearing of *Consumers' Counsel*, *supra*, which we denied by entry dated September 1, 1981, CEI then appealed to the United States Supreme Court, which dismissed for want of a properly presented federal question. See 71 L. Ed. 2d 455 (Jan. 25, 1982).

On October 21, 1981, in case No. 81-1096-EL-COI, the commission again considered the same expenditures and ordered a reduction in CEI's rates as mandated by *Consumers' Counsel*, *supra*. CEI's appeal from that decision was dismissed, on July 7, 1982, without opinion by this court in *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, case No. 82-165. On appeal, the United States Supreme Court again dismissed the cause for want of a properly presented federal question. See 51 U.S.L.W. 3507 (Jan. 11, 1983).

The Office of Consumers' Counsel has been granted leave to intervene as appellee.

The cause is now before this court upon an appeal as of right.

Mr. Alan D. Wright, Mr. Craig I. Smith, Messrs. Squire, Sanders & Dempsey, Mr. Alan P. Buchmann and Mr. Richard W. McLaren, Jr., for appellant.

Mr. Anthony J. Celebrezze, Jr., attorney general, Mr. Marvin I. Resnik, Ms. Marsha R. Schermer and Mr. Harris S. Leven, for appellee Public Utilities Commission.

Mr. William A. Spratley, consumers' counsel, and Mr. Martin J. Marz, for intervening appellee Office of Consumers' Counsel.

*Per Curiam.* In the present appeal, CEI advances three propositions of law. First, CEI urges this court to re-examine its holding in *Consumers' Counsel*, *supra*; second, CEI challenges the constitutionality of R. C. 4909.15 (A)(4); and third, CEI contests the adequacy of the commission's opinion and order.

**Cleve. Elec. Illum. Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 107, 447 NE 2d 746 (1983)**

The question whether the expenditures associated with the four terminated nuclear generating stations may be included in test year expenses as allowable operating expenses was addressed by this court in *Consumers' Counsel, supra*. In that case we held in the syllabus that:

"The Public Utilities Commission's treatment of a utility's investment in terminated nuclear generating stations as amortizable costs to be recovered from the utility's ratepayers is inconsistent with the ratemaking formula contained in R. C. 4909.15 and is unreasonable and unlawful."

In the present case, we are confronted with exactly the same issue arising out of exactly the same set of facts. We are no more persuaded by appellant's arguments today than we were when they were originally advanced in *Consumers' Counsel*. We adhere to our position taken in that case for the reasons expressed therein.

Appellant suggests, however, that such an interpretation of R. C. 4909.15(A)(4) constitutes a confiscation of private property in violation of the Fifth and Fourteenth Amendments to the United States Constitution. We recently addressed this precise constitutional question in *Dayton Power & Light Co. v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 91. After a thorough review of the applicable constitutional standards, we determined that R. C. 4909.15(A)(4) does not violate the Fifth and Fourteenth Amendments, stating, at pages 103-106.

"... Pursuant to the statutory ratemaking formula investors are assured a fair and reasonable return on property that is determined to be used and useful, R. C. 4909.15(A)(2), plus the return of costs incurred in rendering the public service, R. C. 4909.15(A)(4), while consumers may not be charged 'for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs. [Footnote omitted.] We see

**Cleve. Elec. Illum. Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 107, 447 NE 2d 746 (1983)**

no constitutional infirmity in the balance thus struck by the General Assembly.

“••••

“•••• *Per se* confiscation in a utility rate case may exist as an abstract premise, but the constitutional cases make it clear that a successful challenge must demonstrate that the rate order when reviewed in its entirety falls outside the ‘broad zone of reasonableness’ [*Permian Basin Area Rate Cases* (1968), 390 U. S. 747, 770] and the ‘heavy burden’ of establishing unreasonableness must be borne by the challenger. [*FPC v. Hope Natural Gas Co.* (1943), 320 U. S. 591, 602.]

“••••

“•••• *The rule is clear:* “•••• If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry “•••• is at an end.” “••••” (Emphasis added.) Moreover, the Constitution imposes no methodological strictures on ratemaking authorities. See *Dayton Power & Light Co.*, *supra*, at page 98, fn. 8.

CEI has not demonstrated that the rate order in its entirety is confiscatory. The commission submits that CEI’s failure to do so “precludes a finding of confiscation in this case.”<sup>3</sup> The commission specifically adjusted the cost of common equity upward to reflect the perceived increased risk to investors as a result of this court’s decision in *Consumers’ Counsel*, *supra*. See the commission’s order in case No. 81-146-EL-AIR, at page 40, and *Consumers’ Counsel v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 111. This adjustment buttresses the conclusion that the instant order falls

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<sup>3</sup>The commission states in its brief: “•••• [T]he Commission would submit that its rate of return finding, which CEI has not claimed is insufficient or even assailed, precludes a finding of confiscation in this case.”

Cleve. Elec. Illum. Co. v. Pub. Util. Comm.  
4 Ohio St. 3d 107, 447 NE 2d 746 (1983)

within the broad zone of reasonableness. Thus, even if appellant were correct in its assertion [110] that the exclusion based on R. C. 4909.15(A)(4) is improper, there is nothing in the record to suggest that the commission's order, viewed in its entirety, would not still be constitutional because "any rate selected \*\*\* from the broad zone of reasonableness \*\*\* cannot be attacked as confiscatory." *Permian Basin Area Rate Cases*, *supra*, at page 770.

The law set forth in the second paragraph of the syllabus in *Dayton Power & Light Co.*, *supra*, is controlling here: "The Public Utilities Commission's disallowance of a utility's request to treat its expenditures associated with a cancelled generating plant as amortizable costs pursuant to R. C. 4909.15(A)(4) does not violate the Fifth and Fourteenth Amendments of the Constitution of the United States."

We likewise reject appellant's final contention that the commission failed to render adequate findings of fact pursuant to R. C. 4903.09.<sup>4</sup>

R. C. 4903.09 states, in pertinent part:

"In all contested cases \*\*\* the commission shall file \*\*\* findings of fact and written opinions setting forth the reasons prompting the decisions arrived at \*\*\*."

The purpose of R. C. 4903.09 is to provide this court with sufficient details to enable us to determine, upon appeal, how the commission reached its decision. See *General Tel. Co. v. Pub. Util. Comm.* (1972, 30 Ohio St. 2d 271 [59 O.O. 2d 338]). In the present case, we find that

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<sup>4</sup>Specifically, CEI contends that the commission has failed to adequately explain its conclusions on three issues: (1) the computation of the allowance for funds used during construction, (2) the evidentiary ruling made as to a particular exhibit, and (3) the determination of the allowable amount of fuel inventory.

**Cleve. Elec. Illum. Co. v. Pub. Util. Comm.**  
**4 Ohio St. 3d 107, 447 NE 2d 746 (1983)**

the commission's order and opinion contained reasoning that adequately responded to CEI's claim. Indeed, where pertinent, the report alluded to specific passages from the transcript to support its rationale.<sup>5</sup> Accordingly, we find no violation of R. C. 4903.09.

For the above stated reasons, the order of the commission is affirmed.

*Order affirmed.*

CELEBREZZE, C. J., STEPHENSON, SWEENEY, C. BROWN and J. P. CELEBREZZE, JJ., concur.

HOLMES, J., concurs separately.

LOCHER, J., concurs in judgment only.

STEPHENSON, J., of the Fourth Appellate District, sitting for W. BROWN, J.

[111] HOLMES, J., concurring. I concur in the court's resolution of the first issue, which relates to the amortization of the cancelled nuclear generating stations, solely on the basis of *stare decisis*. However, I believe that the proper approach to this question was set forth in Justice Paul W. Brown's dissenting opinion in *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153, 168 [21 O.O. 3d 96], which I joined.

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<sup>5</sup>R. C. 4903.09 contains no requirement that the commission's findings of fact or reasonings be correct. Accordingly, we make no comment on the commission's actual disposition of the issues involved in CEI's third proposition of law.

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

**DECISION AND OPINION OF  
 THE SUPREME COURT OF OHIO**

**CONSUMERS' COUNSEL, APPELLANT, v.  
 PUBLIC UTILITIES COMMISSION OF OHIO ET AL.,  
 APPELLEES.**

*Public Utilities Commission: rate base for determining rate increase may not include customer-supplied funds, when; adjustment for flotation costs proper, when; increased "perceived risk to investors" following court decision properly considered in determining rate of return on common equity; expenditures associated with four terminated nuclear units amortizable, when, R. C. 4905.13.*

(No. 82-1004 — Decided April 13, 1983.)

APPEAL from the Public Utilities Commission of Ohio.

On January 30, 1981, Cleveland Electric Illuminating Company (company) notified the Public Utilities Commission of Ohio (commission) of its intent to file an application for an increase in rates, and of its intent to use the twelve months ending December 31, 1982 as the test period and March 31, 1981 as the date certain. The commission approved the proposed date certain, but directed the company to file its application and supporting exhibits on the basis of a test period with the approved date certain as the mid-point, as well as on the basis of the fully projected test year ending December 31, 1982.

On May 5, 1981, the company formally applied to the commission for the authority to increase its rates and charges for electric service to its customers. Depending on whether the 1980-1981 or 1982 test year is used, the company sought additional gross annual revenues of \$134,834,473 or \$135,293,271. The commission, by order

**Consumers' Counsel v. Public Utilities Comm.  
4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

dated May 27, 1981 accepted the application, assigned this rate case number 81-146-EL-AIR, and on June 17, 1981 granted appellant, Office of Consumers' Counsel the right to intervene. Briefing and hearings followed in due course.

In its opinion and order dated March 17, 1982, the commission approved a rate increase based on the fully projected test year. It allowed the company a return on common equity of 17.30 percent, and further found an overall [112] rate of return of 12.25 percent, upon a rate base of \$1,900,527,000, to be fair and reasonable. The new rates would generate approximately \$1,166,292,000 in gross annual operating revenues, an increase of \$106,977,000.

The cause is now before this court upon an appeal as of right.<sup>1</sup>

*Mr. William A. Spratley*, consumers' counsel, *Ms. Deborah A. Ballam* and *Mr. Martin J. Marz*, for appellant.

*Mr. Anthony J. Celebrezze, Jr.*, attorney general, *Mr. Marvin I. Resnik* and *Mr. Harris S. Leven*, for appellee.

*Messrs. Squire, Sanders & Dempsey*, *Mr. Alan P. Buchmann* and *Mr. Richard W. McLaren, Jr.*, for intervening appellee.

*Per Curiam.* R. C. Chapter 4909 requires the commission to determine just and reasonable rates for services rendered by our state's public utilities. Consumers' Counsel raises questions of law and fact in this appeal from the commission's order, claiming the rate increase allowed therein to be unlawful and unreasonable. We consider these claimed errors under our bifurcated standard of review well-stated by Justice Paul Brown:

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<sup>1</sup>Case No. 82-989, *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 107, decided this date, also arises from the same rate case. Cleveland Electric Illuminating Co., the appellant in that case, is intervening appellee here.

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

"As to questions of fact, this court has repeatedly enunciated the rule that orders of the commission will not be reversed unless they are manifestly against the weight of the evidence or are so clearly unsupported by the record as to shown misapprehension, mistake or willful disregard of duty. [Citations omitted.]

"As to question of law, however, this court has complete, independent power of review. Legal issues are accordingly subjected to more intensive examination than are factual questions." *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 108, 110 [12 O.O. 3d 115].

We address the contentions of Consumers' Counsel in the order in which they arise in the calculation of the rate increase.

As with every application for an increase in rates, the commission first determined the appropriate rate base valuation as of the date certain. R. C. 4909.15(A). Consumers' Counsel challenges the calculation of the rate base, contending the commission as a matter of law improperly failed to deduct from working capital an amount equal to the company's accrued nuclear fuel disposal account balance. At the date certain in this rate case, the accumulated balance was \$3,126,000.

Since the granting of the company's 1978 application for a rate increase, the commission has allowed the inclusion in current operating expenses of deferred costs for the disposal of spent nuclear fuel used at the Davis-Besse Nuclear Power Plant. The spent fuel is presently being accumulated and stored at a temporary site, with ultimate disposal method and cost yet to be determined. It is expected that permanent disposal will occur in the late [113] 1980's, but this future expense is allowed to be included in current operating expenses on the principle that the cost will be incurred due to present operations of

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

Davis-Besse. The amounts included in operating expenses are based on estimates prepared by the United States Department of Energy and these customer contributions are kept in a reserve fund by the company, available for investment. Revenues from investment of the fund are returned to the general fund.

In *Cincinnati v. Pub. Util. Comm.* (1954), 161 Ohio St. 395 [53 O.O. 304], paragraph five of the syllabus, this court held:

"In fixing telephone rates, *customers' contributions in the form of accruals [sic] for the payment of taxes, deposits to secure payment of customers' bills for service or as advances on installation charges, and collections of rents to be paid at future dates, which will be constant with reasonable certainty in the foreseeable future and which are available for investments in materials and supplies, or for use as working capital, should be used as an offset on the allowance for working capital, including investments in materials and supplies necessary for the normal operations of the company and for plant maintenance and repair.*" (Emphasis added.)

The principle underlying this holding is that investors in public utilities should be permitted to earn a return only on that property for which they have supplied funds, not on funds contributed by customers. *Consumers' Counsel, supra*, at 115. By deducting such deposits from working capital, the company's cash flow generated by the customer-supplied account is offset by the hypothetically equivalent reduction in revenues caused by the smaller rate base.

Since *Cincinnati*, this court has consistently applied the principle that a utility may not earn a return on customer-supplied funds which are "constant with reasonable certainty and available for investments." *Consumers'*

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

*Counsel, supra; Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1975), 42 Ohio St. 2d 403 [71 O.O. 2d 393], paragraph nine of the syllabus. Conversely, when such an account is not "constant with reasonable certainty," as with customer deposits in the form of budget billing balances, no offset against working capital and concomitant reduction in rate base are required. *Cleveland v. Pub. Util. Comm.* (1982), 7 Ohio St. 2d 290, 294 [24 O.O. 3d 370].

In the instant case, the commission justified permitting the company to earn interest on the accrued nuclear fuel disposal account without a compensating rate base deduction by stating its intent that the monies earned be used to pay the higher costs expected when actual disposal occurs in the future. The commission speculates that the amounts charged to current customers will be insufficient to cover actual disposal costs and further speculates that the return earned on the account will be available to offset this additional expense.

We note the inherent uncertainty of the estimated cost of permanent disposal and the possibility that such costs may in fact be less than expected. [114] We also note the inability of the commission or company to track precisely the funds earned by this account. Given these facts, we are not persuaded that an exception to the general rule of law should apply. It is uncontroverted that the customer-supplied funds in this account are constant with reasonable certainty and are available for investments. Accordingly, working capital should be offset in the amount of the accrued nuclear fuel disposal account, thereby reducing the rate base. This, in effect, will deny the company a return on accrued customer-supplied funds. By failing to order such an offset, the commission erred as a matter of law and its decision must be reversed.

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

Having determined the appropriate rate base and operating expenses, the commission next considered capital structure, fixing the relative percentage of debt, preferred stock and common equity. It then determined what it believed to be the correct cost for each of these components. After the commission ascertained the cost of capital components, it assigned rates of return which must be "fair and reasonable." From these rates, an overall cost of capital is derived, which is equated with the fair rate of return, and when applied to the rate base, together with expenses, results in the permissible rates to be charged the customer.

Consumers' Counsel disputes the calculation of cost of common equity. It contends the adjustment of the baseline cost of equity to account for a flotation costs<sup>2</sup> improperly included an increased risk to investors as a result of this court's decision in *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153 [21 O.O. 3d 96] (hereinafter "*CEI*"). In that case, this court disallowed the recovery of the costs of four cancelled nuclear plants. Consumers' Counsel here does not dispute that some adjustment was appropriate for flotation costs, but argues that the commission has misused the concept in order to guarantee a return of invested capital in the terminated units.

Whether the figure derived by the commission to reflect flotation costs is correct is a question of fact, there being no dispute that some adjustment for flotation costs is appropriate. Although Consumers' Counsel proposed a different amount, there was sufficient evidence in the record to support the commission's decision to adopt its

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<sup>2</sup>Flotation costs are incurred with the issuance of new or previously unissued stock and includes direct issuance costs such as underwriting fees and printing costs, and indirect costs such as dilution in the value of company stock already on the market.

**Consumers' Counsel v. Public Utilities Comm.  
4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

staff's proposal. In fact, the same range for flotation costs was upheld by this court in *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 303, 310 [21 O.O. 3d 191]. Moreover, nothing in the record evidences any improper considerations underlying the approved amount. Accordingly, we find the flotation cost adopted by the commission neither unreasonable nor against the manifest weight of the evidence.

With respect to the return on common equity, the commission first adopted a range of 17.02 percent to 18.13 percent. This range, derived by the commission staff, gives the commission discretion in selecting a specific point [115] within the range to adjust the return on common equity for the specific facts of the case presented. Although it typically chooses the midpoint of the recommended range, in this case the commission noted two factors which persuaded it to alter this practice. First, the selection of the projected test year as the operating period for rate making purposes was believed to offer the company "a better opportunity to earn its authorized return." This factor, if viewed alone, would support the selection of the low point of the recommended range.

The second factor specifically considered by the commission was "the increase in investors' perceived risk" following release of our decision disallowing recovery of the cost of the four cancelled nuclear plants. The commission had as evidence of the increased risk a relative decline in price for common stock following our announcement of that decision, and the lowering of the company's bond rating by Standard & Poor's, this court's holding being cited as a factor in that action. Consequently, the commission selected 17.30 percent as the appropriate return on common equity, a figure midway between the low point and midpoint of the recommended range.

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

Consumers' Counsel contends that consideration of the increased risk found to arise from our decision in *CEI* when calculating return on common equity violates the holding that ratepayers not pay for the terminated units. The determination of the rate, however, was based on empirical data presented by the company's rate of return witnesses, which testimony was considered relevant to that determination.

R. C. 4909.15(A)(2) requires the commission to determine a fair and reasonable rate of return to the utility. The question whether a decision of this court may have so increased the perceived risk to investors as to require a higher rate of return on common equity is one the commission may consider a factor in its decision. We do not find the commission's action in this regard "so clearly unsupported by the record as to show misapprehension or mistake or willful disregard of duty" and accordingly, find no error.

Finally, in a related issue Consumers' Counsel challenges the commission's decision to authorize the utility to amortize the balances assignable to the four terminated nuclear units over an appropriate period of time not to exceed fifteen years. This book amortization does not affect the rates paid by customers. It is an accounting procedure available as an alternative to writing off the cost of the terminated facilities (the company's share being approximately \$50 million) in a single year. Such book-keeping methodology is not governed by the ratemaking statutes. See *Dayton Power & Light Co. v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 91. Rather, the commission has express statutory authority under R. C. 4905.13 to prescribe the manner in which a utility must keep its

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

books of account. The authorization in this case does not contravene the decision in *CEI* and does not appear so unreasonable as to justify reversal.

Accordingly, the decision of the commission is reversed for its failure to include an offset to the rate base by the amount in the accrued nuclear fuel [116] disposal account, affirmed in all other respects, and the cause remanded for further proceedings in accordance with this decision.

*Judgment accordingly.*

CELEBREZZE, C. J., STEPHENSON, SWEENEY, HOLMES, C. BROWN and J. P. CELEBREZZE, JJ., concur.

LOCHER, J., concurs in part and dissents in part.

STEPHENSON, J., of the Fourth Appellate District, sitting for W. BROWN, J.

LOCHER, J., concurring in part and dissenting in part. I concur in the holding of the majority requiring that *CEI* remove the accrued nuclear fuel disposal account balance from the rate base. I concur in the judgment only as to the accounting treatment of the costs of the cancelled nuclear plants. Otherwise, I dissent.

In *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St. 2d 153 [21 O.O. 3d 96] ("*CEI*"), we refused to allow *CEI* to amortize as costs to be recovered from its ratepayers approximately \$56,400,000 which it had invested in four cancelled nuclear power plants. Regrettably, the majority opinion signals an abject retreat from the stand. What *CEI* condemned, today's holding condones.

Our decision in *CEI* reaffirmed *the* fundamental principle of rate base analysis. That is a plant must be

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

*used and useful* before the PUCO includes it in the rate base.

"If, as has been argued, these are parlous times for the utilities industry, and if, therefore, in order to attract and retain investment capital, utility companies must not only be granted a fair and reasonable rate of return pursuant to statute but must also be assured the return of capital invested in failed projects that would otherwise not be recoverable under the ratemaking formula, then the commission and the utilities should petition the General Assembly to enact changes in the ratemaking structure so as to provide this extra modicum of protection for the investors. Absent such explicit statutory authorization, however, the commission may not benefit the investors by guaranteeing the full return of their capital at the expense of the ratepayers. Under the ratemaking formula now in effect consumers are not chargeable for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs. What we previously stated in a rate base case is applicable to the case at bar: '\*\*\* It is only proper that their [the investors'] venture be found operational before they commence to recoup their capital outlays from the consumers.' *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 449, 456-457 [12 O.O. 3d 378]." (Bracketed material *sic.*) *CEI, supra*, at 167-168, *CEI*, therefore holds that *CEI*'s investors must bear the entire cost of the cancelled plants.

[117] In this case, the PUCO expressly allowed *CEI* to recover an increased return on capital due to an "increase in investors' perceived risk associated with the Court's [*CEI*] decision." The commission accomplished this by raising the rate of return from 17.02 to 17.30 per-

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

cent.<sup>3</sup> This approach by the PUCO allows CEI to gain indirectly, by means of an increased rate of return, what we prohibited it from receiving directly, by means of amortization, in *CEI*. The burden of the (supposedly) increased risk, therefore, is back on the consumers contrary to our observation in *CEI* that ".... the commission may not benefit the investors by guaranteeing the full return of their capital at the expense of the ratepayers." *CEI, supra*, at 167.

Regrettably, today's decision marks the second time that the majority of this court has turned its back on *CEI*. See *Consumers' Counsel v. Pub. Util. Comm.* (1982), 1 Ohio St. 3d 22 ("*Consumers' Counsel* [1982]"). In that case, a procedural subterfuge prevailed over precedent to ensure that the utility would receive payment for its share of the expenses paid toward the same cancelled nuclear plants which were involved in *CEI*. *Consumers' Counsel* (1982), *supra*, at 25 (Locher J., dissenting).

Today, this court falls prey to a combination of semantic and statistical confusion. This is ironic indeed because: (1) the United States Supreme Court dismissed *CEI*'s appeal for want of a properly presented federal question, *Cleveland Elec. Illum. Co. v. Office of Consumers' Counsel* (Jan. 25, 1982), \_\_\_\_\_ U.S. \_\_\_\_\_, 71 L. Ed. 2d 455; and (2) we have recently reaffirmed the holding of *CEI* and upheld its constitutionality in *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1983), 4 Ohio St. 3d 107 ("*CEI* [1983]"): "In the present case, we are confronted

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<sup>3</sup>The PUCO also adjusted the rate of return upward in order to compensate *CEI* for flotation costs. See footnote 2 of majority opinion. We should also reverse and remand the decision of the commission for a determination of the extent to which the adjustment allows a return on investor capital in the cancelled plants and instruct the commission to reduce the rate of return accordingly.

**Consumers' Counsel v. Public Utilities Comm.**  
**4 Ohio St. 3d 111, 447 NE 2d 749 (1983)**

with exactly the same issue arising out of exactly the same set of facts. We are no more persuaded by appellant's arguments today than we were when they were originally advanced in [CEI]. We adhere to our position taken in that case for the reasons expressed therein." *CEI* (1983), *supra*, at 108-109.

We should have summarily reversed the PUCO's holding as to investor risk and flotation costs because *CEI* is *res judicata*. That is, *CEI* stands for the proposition that ratepayers are not to pay for these cancelled nuclear plants. This rule should apply whether the mechanism used to subvert the "used and useful" principle is called "amortization" or anything else. The majority, however, desolates *CEI*.

Accordingly, I would remand this case to the PUCO for a determination as to the extent to which the rate of return includes elements of compensation for the nuclear plants and a reduction of the rate of return consistent with that determination.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****Opinion and Order of the  
Public Utilities Commission of Ohio****(Filed January 5, 1983)****BEFORE****THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of The Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service.	}	<b>Case No.</b> <b>81-1378-EL-AIR</b>
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**OPINION AND ORDER**

The Commission, coming now to consider the above-entitled application filed pursuant to Section 4909.18 Revised Code, and the Staff Report of Investigation issued pursuant to Section 4909.19 Revised Code; having appointed its attorney examiner, Barth E. Royer, pursuant to Section 4901.18 Revised Code to conduct a public hearing and to certify the record directly to the Commission; having reviewed the testimony and exhibits introduced into evidence at the public hearing commencing October 12, 1982 and concluding November 10, 1982; and being otherwise fully advised in the premises, hereby issues its Opinion and Order.

**History of the Proceedings:**

The Cleveland Electric Illuminating Company, the applicant herein, is an Ohio corporation engaged in the business of supplying electric service and steam heating

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

service in this state. As a public utility within the definition of Section 4905.02 Revised Code, an electric light company within the definition of Section 4905.03(A)(4) Revised Code, and a heating company within the definition of Section 4905.03(A)(9) Revised Code, applicant is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06 Revised Code. The company provides retail electric service to some 713,000 customers in a 1,700 square mile service territory which encompasses the greater Cleveland area as well as all or parts of nine northeastern Ohio counties. Applicant also provides steam heating service to some 350 customers within the City of Cleveland, but it is the company's electric operations which are the subject of this proceeding. The company's present rates for electric service were established by Order of this Commission in *Cleveland Electric Illuminating Company*, Case Nos. 81-146-EL-AIR and 81-1565-EL-UNC (March 17, 1982), as subsequently modified by the Commission's Entry on Rehearing in the consolidated docket of May 12, 1982.

On November 13, 1981, The Cleveland Electric Illuminating Company served and filed a notice of its intent to submit a permanent electric rate increase application pursuant to Section 4909.18 Revised Code as required by Section 4909.43(B) Revised Code and Rule 4901-7-01 Ohio Administrative Code. As a part of this prefiling notification, applicant requested that February 28, 1982 be fixed as the date certain for the valuation of property and that the twelve months ending December 31, 1983 be established as the test period for the analysis of accounts. By its Entry of December 9, 1981, the Commission approved the date certain proposed by the company, but found that the company should submit an analysis of accounts based upon a test year with an ending date of

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

August 31, 1982, in addition to the fully-projected test year analysis proposed in its prefiling notification.

The instant application was submitted March 19, 1982, and was accepted for filing as of that date by Commission Entry of April 14, 1982. The form of legal notice proposed by the company was also approved. On May 28, 1982, applicant filed a notice requesting approval of certain amendments to the form of notice initially approved so as to reflect the change in its existing rates resulting from the Commission's Entry of Rehearing of May 12, 1982, in the consolidated cases referred to above. The Commission approved the revised form of notice by Entry of June 23, 1982.

In accordance with the provisions of Section 4909.19 Revised Code, the staff of the Commission conducted an investigation of the matters set forth in the application and the related filings. A written report of the results of the staff investigation was filed September 7, 1982, and was served as provided by law. Objections to the staff report were timely filed by the applicant and by intervenors Consumers' Counsel, City of Cleveland, Industrial Electricity Consumers, Senior Citizens, *et al.*<sup>1</sup>, Fair Rates Campaign Coalition<sup>2</sup>, and the Ohio Cable Television

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<sup>1</sup>Pursuant to the attorney examiner's Entry of October 6, 1982, the participation of intervenor Senior Citizens, *et al.*, has been limited to rate design and tariff questions (*See Senior Citizens Coalition v. Public Utilities Commission*, 69 Ohio St. 2d 625 [1982]). Accordingly, intervenor's objections relating to other matters have been stricken (Tr. II, pp. 74-75).

<sup>2</sup>Pursuant to the attorney examiner's Entry of October 15, 1982, the participation of intervenor Fair Rates Campaign Coalition has also been limited to rate design and tariff questions, and its objections relating to other matters have been stricken (Tr. IV, p. 3)

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Association.<sup>3</sup> Intervenor United States Steel Company filed no objections, and did not subsequently participate in the proceeding.

Pursuant to the Commission's Entry of September 22, 1982, the public hearing of this matter commenced October 12, 1982, at the State Office Building, 615 West Superior Avenue, Cleveland, Ohio, Chairman Jon F. Kelly presiding. The purpose of the Cleveland hearing was to afford members of the public affected by the application the opportunity to present statements concerning the proposed increase. The hearing was reconvened October 18, 1982, at the offices of the Commission, 375 South High Street, Columbus, Ohio, before attorney examiner Barth E. Royer and concluded November 10, 1982. The recorded transcript of the proceeding and the exhibits admitted into evidence have now been certified to the Commission by its examiner for its consideration.

**Appearances:**

Messrs. Alan D. Wright, Vice President—Public Affairs and Legal, and Craig I. Smith, Senior Counsel, Cleveland Electric Illuminating Company, 55 Public Square, Cleveland, Ohio, and Messrs. Squire, Sanders and Dempsey, by Messrs. Alan P. Buchmann and Richard W. McLaren, 1800 Union Commerce Building, Cleveland, Ohio, on behalf of the applicant, The Cleveland Electric Illuminating Company.

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<sup>3</sup>The Ohio Telephone Association filed objections to the Staff Report recommendations relating to the question of pole attachment rates at the time it filed its petition for leave to intervene. However, the petition for leave to intervene was denied by the attorney examiner's Entry of October 8, 1982, a ruling affirmed by the Commission in its Entry of November 3, 1982. Accordingly, those objections should be dismissed.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Mr. William J. Brown, Attorney General of Ohio, by Messrs. Marvin I. Resnik, Harris S. Leven and Donn D. Rosenblum, Assistant Attorneys General, 375 South High Street, Columbus, Ohio, on behalf of the Staff of the Public Utilities Commission of Ohio.

Mr. William A. Spratley, Consumers' Counsel, by Messrs. Martin J. Marz and Steven M. Sherman, Associate Consumers' Counsel, and Ms. Anne L. Hammerstein, Legal Intern, 137 East State Street, Columbus, Ohio, on behalf of the Office of Consumers' Counsel, intervenor.

Mr. James E. Young, Director of Law, City of Cleveland, by Mr. Craig A. Glazer, Assistant Director of Law, Room 106, City Hall, 601 Lakeside Avenue, Cleveland, Ohio, on behalf of the City of Cleveland, intervenor.

Bell and Randazzo, Co., L.P.A. by Messrs. Langdon D. Bell and Samuel C. Randazzo, and Ms. Judith B. Sanders, 21 East State Street, Columbus, Ohio, on behalf of Air Products and Chemicals, Inc., Aluminum Company of America, ELKEM Metals Company, General Motors Corporation, Jones & Laughlin Steel Corporation, L.C.P. Chemicals and Plastics, Inc., PPG Industries, Inc., Sohio Industrial Products, and Union Carbide Corporation (hereinafter "Industrial Electricity Consumers"), intervenors.

Mr. Joseph P. Meissner, Cleveland Legal Aid Society, 1223 West 6th Street, Cleveland, Ohio, on behalf of the Senior Citizens Coalition, the Greater Cleveland Welfare Rights Organization, Inc., and the Western Reserve Alliance, Inc. (hereinafter "Senior Citizens, *et al.*"), intervenors.

Messrs. Vorys, Sater, Seymour and Pease, by Mr. William S. Newcomb, Jr., 52 East Gay Street, Columbus, Ohio, and Messrs. Hogan and Hartson, by Messrs. Gardner F. Gillespie and Paul Glist, 815 Connecticut Avenue, Washington, D.C., on behalf of the Ohio Cable Television Association, intervenor.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Mr. James A. Draper, 33 Public Square, Suite 810, Cleveland, Ohio, on behalf of the Fair Rates Campaign Coalition, Intervenor.

Messrs. Wayne I. Emery and Kenneth P. Pepperny, 600 Grant Street, Room 1569, Pittsburgh, Pennsylvania, on behalf of the United States Steel Company, intervenor.

**Commission Review and Discussion:**

This case comes before the Commission upon the application of The Cleveland Electric Illuminating Company, pursuant to Section 4909.18 Revised Code, for authority to increase its rates and charges for electric service to jurisdictional customers. Applicant alleges that its existing rates are insufficient to provide it reasonable compensation for the service it renders, and seeks Commission approval of rate schedules which would yield some \$233,262,000 in additional gross annual revenue based on test-year operations as analyzed herein.

**ALLOCATIONS**

Because the instant application affects only the company's retail electric sales, it is necessary to allocate property, revenues, and expenses to insure that the rates ultimately authorized reflect only the cost of providing jurisdictional electric service. The staff generally adopted the allocation factors proposed by the applicant, noting that these allocation factors had been derived through the same methodology approved by the Commission in applicant's recent cases (S.R., pp. 3-4). Intervenor City of Cleveland objected to the staff's acceptance of applicant's allocation methodology, but did not pursue the matter at hearing or on brief. The objection is overruled.

# Opinion and Order, PUCO Case No. 81-1378-EL-AIR

## RATE BASE

The following table compares the original company and staff estimates of the value of applicant's property used and useful in rendering electric service to jurisdictional customers as of the date certain of February 28, 1982. Objections to the staff's rate base valuation will be discussed under appropriate subheadings below.

### Jurisdictional Rate Base

(000's Omitted)

	Applicant <sup>1</sup>	Staff <sup>2</sup>
Plant In Service .....	\$2,581,996	\$2,579,861
Less: Depreciation Reserve .....	614,829	618,135
Net Plant In Service .....	\$1,967,167	\$1,961,726
Plus: CWIP .....	421,265	383,131
Working Capital .....	183,025	119,469
Less: Other Items .....	-0-	165,542
Jurisdictional Rate Base .....	<u>\$2,572,457</u>	<u>\$2,298,784</u>

<sup>1</sup>App. Ex. 1B, Sched. B-1

<sup>2</sup>S.R., Sched. 7

### Plant In Service:

As the above table indicates, the difference between the date certain plant in service values initially proposed by the applicant and the staff is relatively small. There are, however, a number of issues relating to the plant in service determination which must be addressed.

### *Land and Land Rights:*

Because the schedules submitted with the application were developed prior to the Commission's decision in *Cleveland Electric Illuminating Company*, Case No. 81-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

146-EL-AIR (March 17, 1982), the rate base valuation originally proposed by the company did not reflect the Commission's determination that certain company-owned land parcels were larger than reasonably necessary to support the utility installations located thereon. Applicant did report these land exclusions in its subsequent filings (App. Ex. ID, Sched. B-2.7), but calculated the associated rate base deductions using a method which differed from that employed by the Commission in the prior case (App. Ex. ID, WPB-2.7.b; Tr. IV, pp. 9-10, 18-19). The Commission determined the amount to be excluded by simply multiplying the booked original cost of the total site by the percentage represented by the acreage determined not to be used and useful. The Commission acknowledged that this calculation implicitly assumed that all land at a given site had a uniform per acre value, but observed that no evidence had been presented upon which to base a determination of the relative value of the included and excluded portions, even had we wished to undertake an analysis of this type. Applicant's witness Moore contends that the site land exclusions as calculated by the company for purposes of this case recognize the difference in value between the included and excluded property, but we find the witness's presentation on this subject to be less than persuasive (Tr. IV, p. 22). The Commission notes, however, that applicant has now identified that portion of the booked original cost of the site properties in question which represent acquisition costs (Tr. IV, p. 12). As we have held on a number of prior occasions, capitalized acquisition costs should not be included as a part of the deduction for excess land (*See, e.g., Ohio Edison Company*, Case No. 78-1567-EL-AIR [January 30, 1980]). Thus, the exclusions must be recalculated so as to apply the percentages determined in the last case to the booked cost less acquisition cost of each of the site properties (App.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Ex. ID, WPB-2.7.b). This produces a total deduction for excess land at the Keppler Substation, the Quaker Substation, the Buckeye Substation, the Mayfield Service Center, and the Parma Radio Station of \$79,482.

In *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR (July 10, 1980), the staff recommended exclusion of three of applicant's ash disposal sites based on its conclusion that the capacity of these areas to receive fly ash had been exhausted. The Commission agreed that two of the sites were not used and useful, but included the company's Vine site in rate base upon a showing that it could still accommodate fly ash and that it was also used to store bottom ash, some of which was eventually sold to municipalities for use as road cinders. In the instant case, the City of Cleveland objected to the staff's failure to investigate whether the Vine site should still be regarded as used and useful, and questioned how the site, which was described as being almost filled to capacity several years ago, could still be capable of receiving fly ash. Staff witness Fox acknowledged that the staff had not made an on-site inspection of the Vine ash disposal site in connection with its investigation in this case in light of the small dollar amount involved, but indicated that the staff had confirmed, through company personnel, that the property was still being used for ash disposal (Staff Ex. 3, pp. 21-22). Applicant's witness Moore expressly so testified (Tr. IV, pp. 97-99), and there is no evidence to the contrary. This objection should be overruled.

*Davis-Besse Gatehouse:*

Based on the results of its field inspection and its review of certain job orders, the staff concluded that a new gatehouse at the Davis-Besse nuclear plant had been improperly transferred to plant in service prior to the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

date certain and recommended that applicant's investment in the facility be reclassified to construction work in progress for purposes of this case (S.R., p. 14). Applicant objected, contending that the first floor of the gatehouse was actually in service at date certain and that the investment should be recognized in rate base as plant in service and not through the construction work in progress allowance (App. Ex. 3A, p. 3). As both the applicant and the staff recognize, the treatment accorded the date certain investment in the first floor of the gatehouse, now fixed at \$1,382,407 (App. Ex. 28, p. 5), becomes material only if the statutory limitation on the construction work in progress allowance comes into play (*See* Section 4909.15 Revised Code). Thus, although the matter has been the subject of considerable debate, the question may well prove rather academic. It certainly has become needlessly complicated.

Applicant has clearly documented that the first floor of the gatehouse, which houses personnel processing facilities, was in service as of February 28, 1982, the date certain in this proceeding (App. Ex. 3A, Appendix A; App. Ex. 3B; App. Ex. 28, pp. 1-5). Staff witness Weiss, although noting that there was still some clean-up, landscaping, and maintenance work being performed at the time of the staff's inspection in May of 1982, apparently does not dispute that part of the gatehouse facility was in use at date certain (Tr. IX, pp. 142-145a; Staff Ex. p. 4; App. Ex. 19). The staff's position, however, is that the first floor of the gatehouse is only a part of a larger project, which also includes the second floor of the gatehouse, as well as an adjacent parking area, and that because the job orders covering this other construction had not been completed by date certain, the entire "project" should be regarded as construction work in progress. The staff's argument mistakes the fundamental point. Although the defini-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

tion of what constitutes a "construction project" within the meaning of that term as employed in Section 4909.15 (A)(1) Revised Code may be significant for purposes of determining whether some particular construction activity is eligible for inclusion in the construction work in progress allowance in a given case, this is all irrelevant where the question is merely whether certain property should be included directly in rate base. That issue is controlled by the statute's "used and useful" criteria, standards which the first floor of the gatehouse clearly satisfied. Accordingly, the Commission finds that applicant's objection should be sustained, and that the jurisdictional portion of the company's date certain investment in the Davis-Besse gatehouse should be restored to rate base.

Through a related objection, intervenor City of Cleveland questioned the staff's finding that the company's plant ledgers and continuing property record (CPR) represented a reliable source of original cost data (S.R., p. 14), in light of the staff's recommendation with respect to the Davis-Besse gatehouse. The short answer, of course, is that the Commission has rejected staff recommendation in question, thereby confirming the reliability of the records. However, staff witness Weiss did respond to this objection through his pre-filed testimony and upon cross-examination (Staff Ex. 2, pp. 5-6; Tr. IX, pp. 176-177), and we find nothing in the record to suggest that the staff's evaluation of the reliability of the company's records was incorrect. Intervenor has not pursued the question on brief. The objection is overruled.

***Beaver Valley Common Facilities:***

This Commission has consistently held that where an applicant utility's ownership interest in a generating station is limited to a unit still under construction, it is improper to include the utility's share of the common facili-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

ties in rate base until such time as the unit, itself, receives rate base recognition, notwithstanding the fact that the common facilities were completed in connection with a unit already in service (*See, e.g., Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]). In such circumstances, the Commission has directed that the common facilities be classified as plant held for future use, with no depreciation to be accrued or AFUDC charged against the subject property (*Cleveland Electric Illuminating Company, supra*). It has become apparent, however, that this practice works a rather unreasonable result, for the utility is denied both rate base recognition as well as AFUDC on the common facilities even though their construction could not have proceeded in any other fashion. As discussed in our decision in *Toledo Edison Company*, Case No. 81-620-EL-AIR (June 9, 1982), the Commission cannot remedy this problem by simply authorizing a resumption of AFUDC, as such a measure would produce a conflict with FERC accounting procedures which require that AFUDC on common facilities cease when the first unit is placed in service. However, where a state commission expressly authorizes the practice, the FERC will accept the accrual and deferral of carrying charges associated with a utility's share of common facilities, equivalent to AFUDC, with the accrued deferral charges to be added to the value of the common facilities when those facilities are determined to be used and useful for state ratemaking purposes (Staff Ex. 8, pp. 9-10). This was the treatment approved in *Toledo Edison Company, supra*, in connection with that company's ownership interest in the common facilities at the Beaver Valley nuclear plant.

Applicant also owns a share of the common facilities at Beaver Valley by virtue of its ownership interest in Beaver Valley Unit No. 2, and has objected to the staff's

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

failure to recommend that it be permitted to adopt the accounting treatment approved for Toledo Edison. At hearing, staff witness Montgomery agreed that applicant should be authorized to accrue and defer carrying charges, equivalent to AFUDC, on its investment in the Beaver Valley common facilities (Staff Ex. 8, pp. 9-10), and the Commission so finds. Consistent with the *Toledo Edison Company*, decision, *supra*, and Mr. Montgomery's recommendation, the authorization to begin accruing carrying charges shall be regarded as prospective in nature, and we will not at this time approve the one time "make up" proposed by applicant's witness Chopp to recognize carrying charges from the time the common facilities were placed in service in 1976 to the present (App. Ex. 5A, p. 27).

***Other Items:***

At hearing, applicant's witness Moore identified two necessary corrections to applicant's proposed plant in service figures (Tr. IV, pp. 4-6). The first correction was to reverse a previous adjustment so as to exclude certain property not yet actually in service as of date certain (App. Ex. 1B, Sched. B-2.2). The second correction excluded certain equipment at the Elden Substation which the Commission had determined not used and useful in *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982). Both the adjustments will be approved.

**Depreciation Reserve:**

Section 4909.05(H) Revised Code requires that the Commission determine the proper and adequate reserve for depreciation to be deducted from the original cost of applicant's used and useful property. The staff recommended that applicant's booked reserve be used as a start-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

ing point in this analysis, but proposed an adjustment to restate the reserve as if the new depreciation accrual rates, which became effective March 1, 1982 as a result of Case No. 81-839-EL-AAM, had been in place throughout the test year (S.R., p. 16; S.R., Sched. 9-1). As discussed *infra*, all parties agree that these new accrual rates should be used to annualize depreciation expense, but applicant has objected to the adjustment to the reserve. The arguments raised by the company in support of this objection are essentially identical to those considered and rejected by the Commission in *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR (May 1, 1981) and *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982), wherein we approved similar ratemaking adjustments to the booked reserve. For those reasons previously stated, and consistent with staff witness Fox's recommendation in this case (Staff Ex. 3, pp. 7-8), the Commission again overrules this objection (See also *Toledo Edison Company*, Case No. 80-377-EL-AIR [April 9, 1981] and *Dayton Power and Light Company*, Case No. 80-687-EL-AIR [July 15, 1981]).

Applicant has also objected to the staff's failure to reduce the depreciation reserve associated with applicant's share of Bruce Mansfield Unit No. 3, on the theory that although book depreciation accruals began when the plant went into service in September of 1980, no depreciation expense was recognized in rates until May of 1981 when *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR, *supra*, was decided. Applicant advanced this same argument in its last rate case, and we again find the objection to be without merit (*Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR, *supra*). As staff witness Fox testified in this case, the notion that rates are designed to recover specific past expenses, or that these expenses are somehow traceable to actual dollars

## **Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

of revenue generated by those rates, mistakes the nature of the ratemaking exercise (Staff Ex. 3, pp. 6-7). The objection is overruled.

The Commission is of the opinion that a jurisdictional depreciation reserve of \$618,135,000 as recommended by the staff is proper and adequate for purposes of this case. Deducting this amount from the original cost of includable property results in a finding of jurisdictional net plant in service of \$1,963,736,000.

### **Excess Capacity:**

Consumers' Counsel and the City of Cleveland both objected to the staff's failure to propose an adjustment for excess capacity in light of the finding in the Staff Report that applicant's installed generating capacity exceeds the level calculated through the staff's 20 percent and 15 percent reserve margin tests (S.R., Sched. 8.2). Consumers' Counsel did not pursue its objection, but the City of Cleveland has once again flailed away at this issue, ignoring everything the Commission and the Supreme Court have had to say with respect to this subject in the past (*See, e.g., Columbus and Southern Ohio Electric Company*, Case No. 77-545-EL-AIR [March 31, 1978]; *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]; *Dayton Power and Light Company*, Case No. 81-21-EL-AIR [February 3, 1982]; *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]; *City of Cleveland v. Public Utilities Commission*, 63 Ohio St. 2d 62 [1980]), and disregarding the expert testimony, including that of its own witness, in this case (Staff Ex. 3, pp. 15, 22-24; App. Ex. 15; Tr. XIII, pp. 51-55). We have repeatedly explained that reserve requirements are company-specific, and that the 20 percent and 15 percent "standards" used by the staff are merely rules of thumb. We have pointed out that it is impossible for a

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

company to add increments of capacity at a rate which will lead to a precise match with some theoretically ideal reserve margin at every point in time, and that increased construction lead-times and the size of units being added today have made attaining and preserving this match even more difficult. We have also explained the conceptual problems which attend a rate base adjustment for excess capacity. Finally, we have identified the real area of concern to be whether, given all the factors which can influence construction and load growth, a company can be fairly said to have acted imprudently in its capacity planning.

There is nothing in this record which suggests that applicant's capacity planning has, in any way, been imprudent. Although City of Cleveland witness Stutz was critical of applicant's present forecasts of future demand (City of Cleveland Ex. 1A, 1B, and 1C), he expressly declined to comment on the company's past capacity planning. Mr. Stutz acknowledged, however, that the company had responded to declining demand forecasts by cancelling the construction of several generating units and deferring the in-service dates of others (Tr. XII, pp. 52-55). Given this testimony, we see no purpose to be served by addressing applicant's witness Raab's criticism of Mr. Stutz's forecasting methodology (App. Ex. 30) or in checking the scoreboard to determine in how many cases his forecasts have been accepted as opposed to the number in which they have been rejected (App. Reply Br., pp. 22-23).

Perhaps the most telling point in connection with this subject is that in the company's prior case the staff concluded that applicant had no excess capacity, while in this case the staff tests revealed excess capacity, even though applicant has added no new capacity in the intervening period (Tr. X, pp. 69-70). How, we ask, was applicant supposed to respond from a capacity planning standpoint

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

to the decrease in load which produced this phenomenon? Clearly the company was not expected to retire an existing unit between the two dates certain, and the Commission will not theoretically dismantle one now. The objections are overruled.

**Construction Work In Progress:**

Section 4909.15(A)(1) Revised Code provides that the Commission may, in its discretion, include in its rate base determination a reasonable allowance for construction work in progress. The statutes limit eligibility for the allowance to projects which are at least 75 percent complete, and further provide that the allowance may not exceed 20 percent of the remainder of the rate base. Applicant proposed eight projects, with a total jurisdictional date certain cost of \$421,290,437, to be considered as evidence by the Commission in establishing the construction work in progress allowance for purposes of this case (App. Ex. 1B, Sched. B-4). Of this amount, \$417,098,137 represents applicant's share of the jurisdictional date certain cost of Perry Unit. No. 1, a nuclear power plant currently under construction (S.R., Sched. 10). The staff determined that seven of the projects, including Perry and its switchyard, satisfied the 75 percent complete test and could be considered by the Commission for inclusion in the allowance. Applicant objected to the exclusion of Project No. 1979 IVPN, which the staff regarded as maintenance rather than construction (S.R., Sched. 10.7), while the City of Cleveland objected to the inclusion of several of the smaller projects, which it apparently considered to be replacement in nature. Staff witness Weiss adequately responded to these objections (Staff Ex. 2, p. 4), and neither party has pursued the matter further. These objections should be overruled.

Both Consumers' Counsel and the City of Cleveland objected to the staff's determination that Perry Unit No.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

1 was 75 percent complete at date certain. In *Ohio Edison Company*, Case No. 78-1567-EL-AIR (January 30, 1980), the Commission was called upon to consider whether Bruce Mansfield Unit No. 3 was 75 percent complete at the date certain and, therefore, eligible for rate base recognition in that proceeding. The question was a close one, and the Commission took great pains to explain its perception of the purpose of the 75 percent standard and to evaluate the multitude of tests and calculations which were offered as evidence of the percent completion of the project. In this case, however, we do not believe that the evidence concerning percent completion of Perry Unit No. 1 requires any such detailed analysis, for the record clearly supports the conclusion that the project was at least 75 percent complete at date certain. In *Ohio Edison, supra*, the Commission was alerted to the need for careful scrutiny by the fact that the construction progress report from the month in which the date certain fell indicated the project to be significantly less than 75 percent complete and by the fact that the testimony offered by the witnesses presenting construction status estimates based on physical inspections was inconclusive. Here, the Perry Nuclear Power Plant monthly progress report for February 28, 1982, indicates that the project was 81.7 percent complete at that date (App. Ex. 14A). The reliability of the report was well supported (Tr. IV, pp. 153-154), and the conclusion contained therein was never challenged. Moreover, all the witnesses offering testimony as to percent completion based on physical inspection, including Consumers' Counsel witness Bridenbaugh, agreed that physical inspection revealed that the project was more than 75 percent complete at date certain (App. Ex. 14, pp. 2-3; Staff Ex. 3, p. 16; OCC Ex. 2, pp. 2, 8-9). In fairness, the Commission must acknowledge that Mr. Bridenbaugh did not recommend that the results of a physical inspection

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

be used as the basis for determining the percent completion of a project, but given the manipulations he performs in connection with the other tests he proposes, we do not believe any of his other findings to be meaningful. One can, of course, imagine all sorts of circumstances which could delay the January, 1984 date by which Perry is expected to produce positive net generation or the May, 1984 commercial date, but speculating and scheduling based on achieved project progress are two different things. Either of these dates, when coupled with a reasonable starting date (Tr. X, p. 101; Tr. IV, p. 16), will show Perry to have been 75 percent complete at date certain on an elapsed time basis. Any reasonable version of the dollars obligated test will yield the same conclusion (App. Br., pp. 25-26). The objections to the staff's finding that Perry Unit No. 1 is eligible for inclusion in the construction work in progress allowance in this case are overruled.

Having determined that the Perry project is eligible for inclusion in the construction work in progress allowance, the question becomes to what extent the investment should be recognized. Consumers' Counsel and the City of Cleveland contend that it should not be considered in the allowance at all, a position we regard as unreasonable given the size of the investment and the length of the construction period. Applicant argues that Perry be included to the maximum amount permitted by law, a proposal we regard as somewhat excessive given the fact the project will not actually be rendering service until 1984. However, we also recognize that applicant has not yet noticed a new rate increase application, and that including Perry in the construction work in progress allowance at a significant level may well forestall the next filing. It will certainly limit the so-called "rate shock" which would result from delaying rate recognition until all of Perry is included in plant in service in some subsequent case (App. Ex. 4A, pp.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

26-27). Thus, in an attempt to recognize all competing factors, we find that Perry should be included at two-thirds of its jurisdictional date certain cost. Combining two-thirds of the jurisdictional date certain cost of the Perry project, or \$278,065,425, with the cost of those other projects determined to be eligible by the staff and netting the result with estimated retirements associated with certain of the projects, produces a construction work in progress allowance of \$282,109,645. The Commission finds this to be a reasonable allowance for purposes of this proceeding.

**Working Capital:**

The applicant and the staff both utilized the formula approach for purposes of determining the allowance for working capital to be included in the rate base valuation pursuant to Section 4909.15(A)(1) Revised Code (App. Ex. 1B, Sched. B-5, S.R., Sched. 11). Although this area is often the subject of considerable controversy, the staff's working capital recommendation in this case drew relatively few objections. Much of the disparity between the company and staff estimates is attributable to applicant's failure to include deductions for accrued taxes and customer deposits in its version of the formula. Although applicant again objected to the staff's recognition of these offsets to the working capital requirement, these issues have long since been laid to rest. (*See Cleveland Electric Illuminating Company v. Public Utilities Commission*, 42 Ohio St. 2d 403 [1975] and *Consumers' Counsel v. Public Utilities Commission*, 58 Ohio St. 2d 108 [1979]). These objections are, again, overruled. Another cause of the difference between the two working capital proposals is tied to the respective positions adopted by the applicant and the staff with respect to certain operating expense issues. The Commission's resolution of those issues, discussed *infra*,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

will, of course be reflected in the working allowance ultimately approved.

*Cash Component:*

Applicant objected to the staff's determination of the cash component of working capital, contending that the staff had failed to adequately recognize fuel expense in its calculation. The only record reference to this objection is in the prefiled testimony of applicant's witness Chopp, who complains about what he characterizes as the "continued erosion" of the original FPC (new FERC) formula (App. Ex. 5A, p. 18). The staff's practice of eliminating fuel and purchased power from operation and maintenance expenses before making the one-eighth calculation is consistent with long-standing Commission precedent. The results of that calculation, when coupled with the additional allowance for the lag in the recovery of fuel expense under the EFC (S.R., Sched. 11.1), produces a reasonable value for the cash component of the working capital allowance. This objection should be overruled.

*Materials and Supplies:*

The staff based its proposed allowance for materials and supplies on the average monthly materials and supplies inventory balances for the period June, 1981 to May, 1982, adjusted so as to exclude materials and supplies held for new construction, additions, and extensions (S.R., p. 16). Applicant's requested allowance is based on the date certain balance (App. Ex. 1B, Sched. B-5). Although the company did adjust this balance to eliminate the so-called "betterments" portion for Standard Filing Requirements reporting purposes, it has again objected to this deduction (App. Ex. 5A, p. 21). As the Commission has repeatedly held, this adjustment is required by the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Supreme Court's decision in *City of Cincinnati v. Public Utilities Commission*, 160 Ohio St. 395 (1954). Although applicant suggests on brief that the Commission has missed the point of its earlier arguments regarding the interpretation and application of this decision, we see nothing in this discussion which the Commission has not addressed before (*See Cleveland Electric Illuminating*, Case No. 79-537-EL-AIR [July 10, 1980]). This objection is overruled.

Applicant next contends that if the Commission is to exclude a portion of the materials and supplies inventory in determining the working capital allowance, the company should be permitted to accrue AFUDC on this amount (App. Ex. 5A, p. 21). As staff witness Fox explained, these inventory amounts should not be regarded as eligible for AFUDC until they become part of a construction project (Staff Ex. 3, p. 10). Applicant acknowledges that the Commission rejected a similar proposal in the company's last case, but argues that the Commission's decision in *Dayton Power and Light Company*, Case No. 82-858-EL-AAM (August 25, 1982) now lends additional support to its position. We fail to see how the circumstances in *Dayton Power and Light Company*, *supra*, which involved the continuation of AFUDC on a major generating facility until it was recognized as plant in service for rate case purposes, are in any way parallel to those presented here. Thus, we will not authorize the accrual of AFUDC on the betterments portion of the materials and supplies inventory.

Although there is certainly nothing improper about using the date certain balance as the starting point for determining the materials and supplies component of the working allowance, the Commission has generally tended to favor the average monthly balance approach on the theory that it may yield a more representative result. Mr.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Fox indicated that the twelve monthly balances used in the staff's calculation represented the most recent data available at the time of the staff's investigation, and that had the test-year monthly balances been available, these would have been the figures the staff would have utilized (Staff Ex. 3, p. 9). This data has now been supplied through an exhibit sponsored by applicant's witness Chopp (App. Ex. 5A, Appendix VI-C), and we agree that this updated information should be used in the calculation. The Commission further finds that the balance from August, 1981, which has been included on Mr. Chopp's exhibit, should be incorporated in deriving the average monthly balance to be used for the materials and supplies component, as the use of thirteen monthly balances serves to bracket the test year and date certain. The Commission has used the thirteen monthly balance method in past Cleveland Electric Illuminating Company cases, and we see no reason to depart from that practice here.

The remaining question in this area centers on the ratio to be used to identify the portion of the materials and supplies balance to be excluded as representing materials and supplies held for future construction, additions, and extensions. Both the applicant and the staff initially used a ratio developed from calendar 1981 data which supported inclusion of 79.31 percent of the balance in the materials and supplies component (App. Ex. 1B, WPB-5.2, d; Staff Ex. 3, p. 9). However, at hearing, applicant proposed the use of a ratio of 81.11 percent which was apparently developed from data from the twelve months ending June 30, 1982 (App. Ex. 5A, p. 20; App. Ex. 1D, WPB-5.2, d). Although applicant asserts on brief that Mr. Fox agreed to the use of this new ratio in the calculation (App. Reply Br., p. 4), that is not how we interpret the staff witness's testimony. Mr. Fox stated that the staff had not reviewed the study upon which the new ratio

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

was based and, therefore, had no basis for recommending that it be utilized (Tr. X, p. 17). Given these circumstances, and in light of the fact that the period examined in developing the new ratio did not coincide with the test year either, the Commission is of the opinion that the use of the ratio originally proposed is appropriate and will produce a reasonable result. Substituting 79.31 percent in the thirteen month average calculation set out in the appendix to Mr. Chopp's testimony (App. Ex. 5A, Appendix VI-C) produces a total jurisdiction materials and supplies component of \$23,255,683, which the Commission finds should be included in the working capital allowance in this case.

*Fossil Fuel Inventory:*

The fossil fuel component of the working capital allowance must take into account the company's necessary investment in both coal and oil inventories. Applicant based its proposed allowance for coal stock on the date certain inventory levels at its generating stations, priced out at estimated year-end 1982 prices (App. Ex. 1B, WPB-5.2, b). The Commission has rejected this technique on a number of prior occasions, including this company's last rate case, finding the use of year-end prices, be they actual or estimated, to be inimical to the concept underlying a date certain rate base valuation (*Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]; *Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979]). We do so again here. The staff, on the other hand, calculated its proposed allowance for coal inventory by first determining a reasonable days' supply for each generating station; and then pricing the inventory level equivalent to that days' supply at date certain prices (Staff Ex. 3, pp. 12-15; App. Ex. 5A, Appendix VII). Although applicant objected generally to

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

the staff's calculation, the company took issue with only two specific aspects of the staff's computation.

Applicant contended that the staff's use of a 45-day supply requirement in connection with the valuation of the coal inventory at the Avon Lake station was unreasonable. Applicant's witness Chopp conceded that the date certain inventory level at Avon Lake was below the company's 55-day target for its wholly-owned plants, but explained that there were special circumstances which had resulted in a temporary reduction in the coal inventory at Avon Lake (App. Ex. 5A, pp. 23-24; *see also* Tr. III, pp. 160-161). Noting that the staff had used the 55-day supply assumption in connection with the company's other generating facilities even though the actual date certain inventory at certain of those stations exceeded the 55-day goal, Mr. Chopp argued that it would be appropriate to use a 55-day supply for the Avon Lake calculation as well (App. Ex. 5A, p. 24). At hearing, staff witness Fox revised the staff's calculation to reflect a 55-day supply at all locations, the inventory level the Commission determined to be appropriate in *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR, *supra*, the company's last case (Staff Ex. 3, pp. 12-13). This change, although increasing the days' supply for Avon Lake, resulted in a reduction in the days' supply for Bruce Mansfield (Staff Ex. 3, p. 13). Mr. Fox also proposed a revision to the average daily burn figures initially used by the staff, pointing out that the estimated values upon which the staff had relied appeared to be overstated when compared to the actual experience during the most recent 12-month period for which data was available (Staff Ex. 3, p. 14). The Commission finds the changes in the days' supply and average daily burn figures proposed by Mr. Fox to be reasonable, and will incorporate these changes in the coal inventory calculation.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Applicant also objected to the price used by the staff for purposes of valuing the coal inventory at the Bruce Mansfield facility. The staff calculated its recommended allowance for Quarto coal at Bruce Mansfield based on the Quarto cost recognized for EFC purposes (Staff Ex. 3, p. 13). Mr. Chopp argued that although the allowable pass-through of Quarto coal costs had been limited in prior EFC proceedings, the inventory valuation for rate case purposes reflect the actual price paid for Quarto coal (App. Ex. 5A, pp. 24-25). Staff witness Fox agreed and revised the staff's calculation by substituting the date certain price of Quarto coal for the EFC cost originally used by the staff (Staff Ex. 3, pp. 13-14). This adjustment, coupled with those other changes previously discussed, results in a revised staff jurisdictional coal inventory allowance recommendation of \$46,085,006 (Staff Ex. 3, p. 14), which the Commission finds to be reasonable.

Applicant calculated its proposed allowance for the oil inventory using the same methodology it employed in connection with the coal component. The staff determined an allowance for oil inventory by multiplying the quantities reflected in the 13-monthly average balances by the applicable date certain price (S.R., p. 16; App. Ex. 5A, Appendix VII). However, the staff recommended that the oil inventory allowance proposed by the company, which was lower than that which resulted from its own calculation, be accepted for purposes of this case. Applicant objected, claiming that it was improper for the staff to recommend acceptance of the company's proposal simply on the grounds that it produced a lower number. As the Commission has often observed, there are a number of reasonable methods available for determining the allowance from the various inventories included in the total working capital allowance. Were we confronted here with

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

a choice between two values, both of which resulted from reasonable methods properly applied, we might be somewhat more receptive to the staff's "least cost" argument (Tr. X, pp. 23-24). In this case, however, we have already specifically rejected the method used by applicant to develop its proposed allowance for oil inventory, as it is precisely the same method that we found inappropriate for determining the allowance for coal stock. Consistency requires that we adopt the oil inventory allowance determined by the staff. Combining this jurisdictional oil inventory allowance of \$15,198,607 with the coal stock allowance approved above produces a fossil fuel inventory allowance of \$61,283,613 which we find reasonable for purposes of this proceeding.

*Deferred EFC Balances:*

Several parties filed objections relating to the staff's inclusion of a component in working capital for deferred EFC fuel expense (S.R., Sched. 11.2). However, as the parties and the staff have recognized, the matter of the recovery of carrying costs associated with the deferred EFC balances is now the subject of a separate generic proceeding, Case No. 80-928-EL-ORD. Thus, there is no need to address the question in the context of this case.

*Deferred Nuclear Fuel:*

Intervenor City of Cleveland objected to the staff's inclusion of an allowance for deferred nuclear fuel in its determination of applicant's working capital requirements. As a review of the Commission's discussion of the question in *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR (July 10, 1980) will indicate, deferred nuclear fuel is just as proper a component of the working

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

capital allowance as are the fossil fuel inventory balances. The purpose of the inclusion of an allowance for deferred nuclear fuel is not to provide for recovery of these deferred costs as intervenor erroneously asserts on brief (City of Cleveland Br., p. 29), but rather to afford the company a return on funds that have been invested but not yet recovered. This objection is without merit and is overruled.

*Deferred Quarto Coal Costs:*

Both the applicant and the staff included a component in their working capital calculations to recognize deferred Quarto coal costs (App. Ex. 1B, Sched. B-5; S.R., Sched. 11). Consumers' Counsel and the City of Cleveland have again objected, but have presented nothing in the way of evidence or argument which would persuade the Commission that it is inappropriate to include an allowance for the deferred Quarto balance in working capital (See, e.g., *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]; *Ohio Edison Company*, Case No. 81-1171-EL-AIR [November 3, 1982] *Toledo Edison Company*, Case No. 81-620-EL-AIR [June 9, 1982]). Through a related objection, Consumers' Counsel pointed out that the staff did not calculate the allowance for the Quarto coal cost deferral on a net of tax basis. Staff witness Montgomery agreed, and presented a revised allowance for this item of \$12,315,000 which the Commission finds reasonable for purposes of this case (Staff Ex. 8, p. 14).

*Working Capital Summary:*

The following schedule presents the Commission's determination of the allowance for working capital to be included in rate base in this proceeding.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****Jurisdictional Working Capital Allowance****(000's Omitted)****Cash Element**

( $\frac{1}{4}$ of Adjusted Operation and Maintenance Expense, excluding Fuel and Purchased Power) .....	\$ 33,685
Fuel Expense Lag .....	6,773
Materials and Supplies .....	23,256
Fossil Fuel Inventory .....	61,284
Deferred Nuclear Fuel .....	4,071
Deferred Quarto Coal Costs .....	12,315
Less: Customer Deposits .....	1,217
<b>Tax Offset</b>	
( $\frac{1}{4}$ of Adjusted Taxes, excluding FICA, deferred FIT, and Additional Ohio GRT) .....	29,307
<b>Jurisdictional Working Capital Allowance .....</b>	<b><u><u>\$110,860</u></u></b>

**Other Rate Base Deductions:**

The staff made its customary adjustment to reduce rate base by the jurisdictional portion of the date certain balance of accumulated deferred taxes associated with accelerated amortization, liberalized depreciation, and those accumulated deferred investment tax credits which may be deducted without loss of benefit (S.R., p. 16; S.R., Sched. 12). Applicant filed its usual general objection to the deductions for these items, which account for something in excess of \$142,000,000 of the difference between the applicant and staff rate base valuations, but has apparently finally decided to leave this dead horse alone as it did not pursue the matter at hearing or on brief. The objection is overruled (*See, e.g., Cleveland Electric Illuminating Company, Case No. 79-537-EL-AIR [July 10, 1980]*).

There are, however, a number of specific objections to the staff deductions for accumulated deferred taxes and

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

tax credits, as well as to certain other rate base deductions the staff has recommended for purposes of this case. In addition, there are several objections through which various parties argue that the staff should have recognized certain other items as rate base offsets. We will take up these matters, in turn, below.

*ITC – Projects Not In Rate Base:*

Applicant objected to the staff's inclusion of investment tax credit claimed on qualified progress expenditures on projects not included in rate base in its calculation of the deferred investment tax credit deductions (App. Ex. 9A, pp. 10-11). Staff witness Montgomery agreed that the tax credit associated with such projects should not have been deducted (Staff Ex. 8, p. 12), and the Commission so finds. In this connection, the Commission notes that in light of the inclusion of only two-thirds of the Perry Unit No. 1 investment in the construction work in progress allowance, the investment tax credit associated with that portion of the date certain investment in Perry not included in rate base may not properly be used to reduce rate base. Thus, the rate base deduction for the four percent portion of investment tax credit on qualified progress expenditures should be \$1,784,950.

*Tax Benefit Transfers:*

The applicant, the staff, and Consumers' Counsel each propose a different rate base treatment for the proceeds from the sale of tax benefits under the "Safe-Harbor Lease Election" created by the Economic Recovery Tax Act of 1981. Applicant's witness Jirousek recommends that there be no rate base deduction, apparently on the grounds that if subsequent Treasury Department regulations dictate that all the proceeds be treated under the investment tax

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

credit rules, a rate base deduction might jeopardize the transactions (App. Ex. 9A, pp. 7-9). The staff recommends that the proceeds be segregated into two components, an ACRS portion and an investment tax credit portion, with the rate base deduction to reflect the unamortized balance of the ACRS component (S.R., p. 12; Staff Ex. 8, pp. 7-8); Consumers' Counsel witness Effron proposes that all proceeds for the sale of tax benefits be deducted, on the theory that both the ACRS portion and the investment tax credit portion represent non-investor supplied funds (OCC Ex. 1, pp. 25-26). However, Mr. Effron acknowledges that he would not extend this principle to instances where a prohibition against a rate base deduction exists which would cause the loss of the benefit (OCC Ex. 1, p. 26). As staff witness Montgomery testified, it is precisely this consideration which has prompted the staff to treat the ACRS portion and the investment tax credit portion differently (Staff Ex. 8, pp. 14-15). The City of Cleveland, although presenting no witness on the subject, also argues that all proceeds from the tax benefits transfers should be deducted from rate base and relies on an April 13, 1982 exposure draft issued by the Financial Accounting Standards Board (App. Ex. 17) in support of its position that the anticipated Treasury Department regulations may well not contain any prohibition against such a rate base deduction (City of Cleveland Br., pp. 31-33).

The Commission had occasion to consider this precise question in its recent decision in *Ohio Edison Company*, Case No. 81-1171-EL-AIR (November 3, 1982), wherein we concluded that the ratemaking treatment of the proceeds of the tax benefit transfers should conform to the treatment which would be followed assuming the benefits had been taken directly by the applicant. Nothing in this record would persuade us to alter that view. We had the benefit of the same FASB exposure draft in *Ohio Edison*

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

*Company, supra* and although we have heard considerable argument as to its implications we remain of the opinion that the staff's proposed rate base treatment of the proceeds of the tax benefit transfers which is consistent with full normalization is appropriate. Indeed it now appears that this exposure draft has been withdrawn (App. Br. Appendix A). Accordingly the Commission finds that the staff's proposed deduction should be approved. The objection of applicant Consumers' Counsel, and the City of Cleveland are overruled.

*Capitalized Employee Benefits:*

As discussed *infra*, the Commission has accepted the staff's recommendation that applicant be permitted to practice deferred tax accounting with respect to capitalized employee benefits which are currently deductible for federal income tax purposes. Thus, rate base should be reduced to reflect the associated deferred taxes (Staff Ex. 8, p. 18). Although Consumers' Counsel has filed an objection which goes to the question of whether normalization should be approved for this item, Consumers' Counsel witness Effron agrees that if deferred tax accounting is authorized, the staff's rate base deduction is appropriate (OCC Ex. 1, p. 54). Accordingly, the Commission finds that the staff's proposed deduction of \$1,102,000 should be approved (S.R., Sched. 12).

*Accumulated Deferred Taxes — Nuclear Fuel:*

Consumers' Counsel objects to the staff's use of the date certain balance of accumulated deferred taxes relating to nuclear fuel as the basis of the rate base deduction for this item. Consumers' Counsel witness Effron contends that because the deferred nuclear fuel cost reflected in the working capital allowance is based on an average of 13-monthly balances, the use of the date certain deferred

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

tax balance creates a mismatch (OCC Ex. 1, p. 24). Staff witness Montgomery argued that the staff method produced a reasonable result (Staff Ex. 8, p. 14), but indicated that an alternative approach would have been to simply include nuclear fuel in working capital on a net of tax basis (Tr. XIII, pp. 124-127). This would have produced a result equivalent to that recommended by Mr. Effron (OCC Ex. 1, Sched. RB-4, p. 5). Upon review of the record relative to this subject, the Commission agrees that the adjustment proposed by Mr. Effron properly synchronizes the rate base deduction for accumulated deferred taxes associated with nuclear fuel with the deferred nuclear cost recognized in the working capital allowance. Thus, the Commission finds the staff's proposed deduction for accumulated deferred taxes associated with nuclear fuel to be understated, and, accordingly, will reduce rate base by an additional \$509,000 (OCC Ex. 1, p. 24).

***AFUDC Adjustments:***

In *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982), the Commission determined that applicant had, since 1977, been using an improper method for booking AFUDC and directed the company to restate its capital accounts to reflect the booking of AFUDC on a net of tax basis for the period in question. The Commission further provided for a rate base deduction to give effect to its finding that AFUDC had been overbooked, indicating that a similar measure would be necessary in subsequent cases until such time as the restatement could be completed. The staff has proposed such a rate base adjustment in the instant case (S.R., p. 17; S.R., Sched. 12), to which the company has objected. Although applicant continues to maintain that its method of booking AFUDC was not improper, it is pursuing that argument through other channels and has not attempted to

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

relitigate that question in this proceeding. The company's specific objection here is that the staff's deduction is overstated in that the staff has reduced rate base by an amount equal to all excess AFUDC, not just that associated with property which is in rate base (App. Ex. 5A, pp. 27-29). Applicant agrees that if one accepts the premise that AFUDC has been overbooked, it is appropriate to reduce rate base so as to eliminate the excess AFUDC. Applicant contends, however, that one cannot properly deduct an AFUDC component from rate base which was not in rate base to begin with. Were it not for the tax consequences which flow from the overbooking of AFUDC, the Commission would agree that the only adjustment necessary would be to eliminate the excess AFUDC associated with rate base property. However, the fact is that these tax consequences must be recognized, and the staff's adjustment is a reasonable way to accomplish this result (Tr. XIII, pp. 142-150, 162-172).

Applicant, of course, books AFUDC in connection with all construction work in progress, regardless of whether that construction is included in rate base. Moreover, all AFUDC gives rise to a tax benefit in the form of an interest expense deduction. The Commission's method of calculating the interest expense deduction to be used in determining the allowance for federal income tax expense, which is to multiply the rate base by the weighted cost of debt, automatically normalizes this tax benefit so long as company has consistently booked AFUDC net of tax. No further adjustment is required, either to rate base or in the federal income tax calculation, as the tax benefit associated with AFUDC has already been fully allocated. The value of property currently in rate base has been reduced by the amount of the tax benefit, and future customers share in the benefit as construction not currently recognized in rate base goes into rate base at a similarly reduced value. However, where a company has booked

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

excessive AFUDC, the interest deduction available to the company will be greater than that to which it would have been entitled had AFUDC been properly booked net-of-tax. Simply reducing rate base by eliminating the excess AFUDC component will not remedy this problem, as the company still retains the entire benefit of the excess interest deduction associated with property not yet in rate base. That benefit must be passed on to customers, and there are two ways by which this can be accomplished. The deduction could be flowed through directly as a deduction to federal income tax expense, or, as the staff has proposed, it can be deferred and used to reduce rate base. As the Commission has consistently approved interperiod tax allocation for interest deductions since normalization became permitted under Ohio law, we believe the staff method to be the more appropriate of the two. Thus, the staff's proposed rate base deduction for this item of \$9,608,009 should be approved. Applicant's objection is overruled.

Intervenor City of Cleveland has also filed an objection through which it proposes an adjustment to the AFUDC component of certain rate base property. In *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR, *supra*, the City of Cleveland argued that the Commission should disallow AFUDC on a waste water treatment project (1976-1WW) which applicant had proposed for recognition in the construction work in progress allowance in that case. The City's argument was based on its claim that the construction time for this project had been excessive, which, in turn, had served to generate an excessive AFUDC accrual. However, the only "evidence" intervenor presented to substantiate its contention that the construction time had been excessive was a copy of a complaint in a suit filed by the State of Ohio against the company which contained allegations that there had been unreasonable delays in completing the project. The Commis-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

sion, finding this to be a less than satisfactory evidentiary showing, summarily rejected intervenor's argument.

The City of Cleveland again raised this issue through a filed objection in the instant case, but did not pursue the matter at hearing. However, intervenor has appended a newspaper clipping to its brief which reports that a consent agreement has now been filed in the lawsuit referred to above pursuant to which the company will pay a civil penalty, purchase a new water pollution control testing system, and install new on-site laboratories at three plants. Based on this clipping, intervenor would now have us exclude the AFUDC component of the 1976-IWW property from rate base. The contents of this newspaper clipping, even if properly before us, would no more support a finding that the construction time for the waste water treatment project was excessive than did the copy of the complaint offered in the last case. Until there is an evidentiary showing which supports such a finding, the Commission need not reach the question of whether an AFUDC adjustment is appropriate. This objection should again be overruled.

*Accrued Nuclear Fuel Disposal Costs:*

Consumers' Counsel has again objected to the staff's failure to deduct accrued nuclear fuel disposal costs from rate base. The Commission has addressed this issue on a number of prior occasions, including this applicant's last rate case, and has consistently rejected Consumers' Counsel's argument (*See, e.g., Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR, [March 17, 1981]; *Ohio Edison Company*, Case No. 81-1171-EL-AIR, [November 3, 1982]; *Toledo Edison Company*, Case No. 81-620-EL-AIR [June 9, 1982]). Intervenor has presented nothing new in support of its objection; in fact, its witness has offered the same testimony submitted in the prior case (OCC Ex. 1, Appendix B). As the Commission has

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

explained, and as staff witness Montgomery suggests in this record (Staff Ex. 8, pp. 15-16), the company should be permitted to earn a return on these accrued funds to offset the effects of inflation on the adequacy of the accrued balance at the time of fuel disposal. The Commission continues to view this measure as a reasonable attempt to prevent future ratepayers from being subjected to costs which all consider are properly regarded as a function of the consumption of the nuclear fuel. The objection should again be overruled.

*Accrued Breeder Reactor Corporation Payments:*

Through supplemental testimony, Consumers' Counsel witness Effron recommended an adjustment to test-year operating expenses to eliminate \$226,000 which represented budgeted payments to the Breeder Reactor Corporation which were included in the forecasted portion of the test year but which were not, in fact, paid (OCC Ex. 1, pp. 3-4). Noting that the company had actually made no payments to the Breeder Reactor Corporation since 1977, Mr. Effron also proposed a rate base deduction for any amounts accrued through rates which reflected budgeted Breeder Reactor Corporation payments which had not been made (OCC Ex. 1, p. 4). Although applicant's witness Zitzman has indicated that the Breeder Reactor Corporation may well call the annual payment in the near future (App. Ex. 29, p. 9), we find this to be too speculative a basis to support inclusion of these payments in test year cost of service, and our finding of allowable test year expenses, *infra*, will so reflect. Indeed, a similar claim was advanced in *Cincinnati Gas and Electric Company*, Case No. 81-66-EL-AIR (January 27, 1982), wherein we also excluded Breeder Reactor Corporation payments in determining allowable expenses.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

The Commission does not believe, however, that this record will support a rate base deduction for any Breeder Reactor Corporation payment costs which may have been reflected in customer rates. As Mr. Zitzman points out, applicant had no accrued balance for Breeder Reactor Corporation payments at date certain, as this item was not included in cost of service in recent rate cases until *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982), the company's last rate proceeding (App. Ex. 9B, p. 9). Applicant argues that although the rates approved in the last case did reflect Breeder Reactor Corporation payment costs, those rates were not in effect until after date certain, thereby distinguishing this case from *Cincinnati Gas and Electric Company*, *supra*, where a rate base deduction was approved upon a showing that an accrued balance existed due to the fact that the company had continuously included the payments in cost of service in its rate cases. In any event, Mr. Effron never quantified any specific deduction, and there is no evidence which would permit the calculation of an accrued balance even if the Commission deemed a deduction to be appropriate.

*Clearing Account Allocations:*

Applicant proposed an adjustment to cost of service to reflect a change in the company's procedure for allocating supervision and overhead clearing accounts between expense and property (App. Ex. 5A, p. 3; App. Ex. 1D, Sched. 3.18). This change, which was implemented July 1, 1982, resulted in an increase in the assignment of supervision and overheads to expense accounts and a corresponding decrease in the assignment to property accounts. Because this allocation procedure will continue to be used in the future, the company contends that the effect of the change should be annu-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

alized so that the test year expense levels will be representative for ratemaking purposes (App. Ex. 5A, p. 4). Staff witness Montgomery agreed (Staff Ex. 8, p. 6), and the Commission will approve the adjustment for cost of service purposes in this case. Consumers' Counsel witness Effron does not oppose the expense adjustment, but argues that if it is to be approved, there should be a corresponding rate base deduction to recognize that if the change had been in effect throughout the year, the date certain rate base would have been lower (OCC Ex. 1A, p. 5). The Commission does not agree that such an adjustment is appropriate. This expense adjustment is entirely prospective in nature. The company has not proposed to restate its capital accounts as a result of the change in the accounting procedure, nor has there been any suggestion that it would be appropriate for it to do so. The Commission believes a rate base deduction of this type to be inconsistent with the date certain concept, and must reject this proposal.

**Rate Base Summary:**

In light of the foregoing discussion, the Commission finds the jurisdictional rate base, as of the date certain of February 28, 1982, to be as set forth on the following table:

<b>Jurisdictional Rate Base</b> <b>(000's Omitted)</b>	
Plant In Service .....	\$2,581,871
Less: Depreciation Reserve .....	618,135
Net Plant In Service .....	\$1,963,736
Plus: CWIP .....	282,110
Working Capital .....	110,860
Less: Other Items .....	158,287
Jurisdictional Rate Base .....	<u>\$2,198,419</u>

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****OPERATING INCOME**

Applicant and the Commission's staff each submitted analyses of test-year accounts reflecting the results of operations under applicant's present rates. Consumers' Counsel has also presented evidence in support of proposed adjustments to the staff's findings. Issues raised by the filed objections of the parties are discussed below.

**Test Year:**

Section 4909.15(C) Revised Code provides that the test period for the revenue and expense analysis shall be the twelve-month period beginning six months prior to the date the application is filed, unless the Commission orders otherwise. As a part of its prefiling notification in this case, applicant requested that the Commission approve calendar 1983 as the test period, rather than the customary partially-projected test year with a date certain midpoint, here, the twelve months ending August 31, 1982. By its Entry in this docket of December 9, 1981, the Commission directed the company to file two analyses of accounts, one based on the standard, partially-projected test year, and one based on the future test period initially proposed.

Subsequent to the filing of the instant application, the Governor signed into law Amended Substitute Senate Bill No. 378, which amends Section 4909.15(C) Revised Code to prohibit the approval of a test period ending more than nine months after the date the rate application is filed. Although this change does not become effective until January 11, 1983, the staff, in light of this legislation, presented only the results of its analysis of the standard test year in the Staff Report, and has not recommended that the future test year be used as a basis for setting rates (S.R., p. 13; Staff Ex. 8, p. 3). Applicant objected

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

to the staff's failure to recommend that the future test period be approved.

The Commission has had occasion to consider this same question in its recent decisions in *Ohio Edison Company*, Case No. 81-1171-EL-AIR (November 3, 1982) and *Columbus and Southern Ohio Electric Company*, Case No. 81-1058-EL-AIR (November 5, 1982). In both instances, the Commission concluded that it would be inappropriate to approve rates based on a future test period in the face of a new law which will specifically prohibit that very measure. We remain of that view. Applicant's objection is overruled, and the twelve months ending August 31, 1982 will be adopted as the test period for purposes of this proceeding. Revenues and expense findings will be based on the combination of four months' actual data and eight months' forecasted data as presented in the company's standard test year analysis (App. Ex. 1B), subject to appropriate ratemaking adjustments.

**Fuel Revenue and Expense:**

Due to the operation of the company's fuel cost recovery mechanism (Chapter 4901:1-11 Ohio Administrative Code), the determination of adjusted gross annual revenue turns, in part, on the treatment accorded fuel expense. For purposes of its report, the staff based its annualization of fuel revenue and fuel expense on the EFC rate effective March, 1982 (S.R., p. 6), but agreed with a company objection that this calculation should be revised to reflect the September, 1982 EFC rate so as to synchronize includable fuel costs with fuel revenues (Staff Ex. 7, pp. 3-4). Applicant's witness Blank offered a revised annualization adjustment at hearing (App. Ex. 6B), and there is now apparently no disagreement with respect to this matter (Tr. VI, pp. 10-11; Tr. XI, pp. 30-31). As this was the only revenue issue raised in the case, the Commission

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

now finds applicant's adjusted test-year operating revenue for purposes of this proceeding to be \$1,201,906,000.

Through a filed objection, intervenor City of Cleveland alleged that the staff had improperly included an allowance in fuel expense for penalty demurrage charges incurred by the company. As staff witness Hess testified, this is a matter subject to review in fuel hearings, and has no place in a base rate proceeding (Staff Ex. 7, p. 19). Intervenor did not pursue the matter at hearing or on brief. The objection is overruled.

**Labor Expense:**

There are several issues in this proceeding which affect the determination of the proper allowance for labor expense. We turn first to the questions relating to the annualization of wage increases. As a preliminary matter in this regard, we note that the staff has agreed that corrections are required to remedy clerical errors in certain of the wage annualization adjustments set out in the Staff Report (Staff Ex. 4, pp. 5-6). The corrections, as identified by applicant's witness Chopp (App. Ex. 5A, pp. 7-8) and Consumers' Counsel witness Effron (OCC Ex. 1, p. 29), will be incorporated in the calculation of the allowance for labor expense approved for purposes of this case.

Applicant annualized labor and labor-related expenses to reflect all known and scheduled wage increases which will be in place during the period the rates set in this proceeding will be in effect (App. Ex. 1B, Sched. C-3.9). The staff agreed that all known wage increases which occurred during the test year should be annualized, but, citing the Ohio Supreme Court's decision in *Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St.2d 372 (1981), reversed applicant's adjustment for post test-year wage increases (S.R., p. 7; S.R. Sched. 3.8, 3.8a-3.8d; Staff Ex. 4, p. 4). Accordingly, staff witness Brown indicated that the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

unit employee increase effective August 1, 1982, which occurred during the test year but which was not known and certain at the time of the staff audit, should be annualized, and recommended acceptance of the company's calculation of this adjustment (Staff Ex. 4, pp. 4-5; App. Ex. 5A, Appendix 1-B). However, the issue raised by applicant's objection to the staff's failure to recognize the post test year increases remain for the Commission's consideration.

Applicant argues that the facts of this case are distinguishable from those before the Court in *Consumers' Counsel, supra*, and that the Court's holding relative to post test-year cost changes should not be applied here (App. Br., pp. 41-42). We have been confronted with similar arguments in several cases since the *Consumers' Counsel* decision, *supra* (See *Dayton Light and Power Company*, Case No. 81-21-EL-AIR [February 3, 1982]; *Toledo Edison Company*, Case No. 81-620-EL-AIR [June 9, 1982]). Although we have expressed concern as to the ramifications of a sweeping interpretation of the decision, we have indicated that we do not believe it to be our place to undertake the type of fine tuning which would be required if we were to accept that the distinctions which have been argued to be critical (*Dayton Power and Light Company, supra*; *Toledo Edison Company, supra*). Thus, applicant's objection to the staff's failure to reflect post test-year wage increases in its calculation of allowable labor expense should be overruled.

The finding that only those wage increases which occurred during the test year should be recognized for purposes of determining annualized labor expense does not end the wage annualization controversy. Applicant objected to the staff's failure to recognize the increase in Bruce Mansfield labor costs resulting from a seven percent increase in unit employee wages. Staff witness Brown

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

agreed that the increase should be annualized if it occurred during the test year, but pointed out that applicant's filings clearly indicated that the increase in question was to take effect September 1, 1982 (Staff Ex. 4, pp. 6-7; App. Ex. 1B, WPC-3.9,c). Applicant's witness Chopp, in his supplemental testimony, reported that the increase had actually become effective August 16, 1982 (App. Ex. 5A, p. 13), but was unable to offer any explanation as to why this change had occurred (Tr. III, pp. 30-32). In light of the significance of the dates involved and the fact that the increase was apparently governed by union contract, staff counsel asked for further clarification (Tr. III, p. 33). None has been provided. Given this state of the record, the Commission does not believe the adjustment should be approved.

The allowance for labor expense is, of course, also a function of the number of employees. Although the company's operating budget provides the basis for the employee levels assumed for the projected months of the test year in applicant's filings, the staff reviews the actual test-year employee census to assure that it is within acceptable limits of the budgeted number (S.R., p. 7). This review is particularly important where the company involved has exhibited a history of large variations between actual employees on board and budgeted positions to insure that only a representative employee level is utilized for calculating payroll expense for ratemaking purposes. As in *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR (May 1, 1981) and *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982), the staff, in this case, has again recommended that there be an adjustment for overbudgeted employees (Staff Ex. 7, p. 5).

The Commission has recognized a number of different techniques for dealing with this problem (See, e.g.,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

*Toledo Edison Company*, Case No. 80-377-EL-AIR [April 9, 1981] and *Dayton Power and Light Company*, Case No. 80-687-EL-AIR [July 15, 1981]), including that proposed by the staff in this case. Here, the staff recommendation is simply to eliminate the labor expense associated with the average monthly non-hires from the projected months of the test year (S.R., Sched. 39.). Applicant objected to any adjustment for overbudgeted employees, but, if one is to be made, recommends that it be based on the 84 non-hires for August of 1982, on the theory that the year-end employee level is more representative of the situation which will prevail during the period the rates set in this proceeding will be in effect (App. Ex. 5A, pp. 10-11). The evidence simply does not support this proposition, for it is apparent that the number of non-hired employees tends to run in a cycle and that the August number is no more representative of the annual experience than the number from any other single month (Tr. III, pp. 20-21, 90-21, 100-101). We do agree, however, that the staff's use of the average non-hires for the period January through May of 1982 is also inappropriate, and will base the adjustment on the average of 120 non-hires derived from data from all eight of the projected months of the test year rather than the 131 employee figure proposed by the staff (App. Ex. 5A, p. 10).

Applicant also argues that the staff's method of calculating the overbudgeted employee adjustment understates labor expense in that it assumes that the non-hires are all at the company average monthly per-employee labor cost and that the electric operating ratio is applicable to the unfilled positions (App. Ex. 5A, pp. 11-12). The Commission is not persuaded that the various refinements proposed by applicant will necessarily produce a more accurate or representative result than the staff's calculation (App. Ex. 5A, p. 12; App. Ex. 29, pp. 1-3). First, appli-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

cant calculated its proposed average monthly labor cost per non-hired employee by using the starting salary for each unfilled position as of August 27, 1982. This might be appropriate if one were to use the August non-hires as the basis for the adjustment, but, as indicated above, this is not the figure the Commission has used. Second, the analysis undertaken by the company in an attempt to show that the unfilled positions are concentrated in employee groups which are more capital-intensive than expense-intensive does not really tell us a great deal about the characteristics of the individual unfilled positions (Tr. XV, pp. 67-69). Given the nature and purpose of the adjustment, we consider the staff's use of the company average monthly labor cost per employee and the electric operating ratio to be reasonable, and will adjust only the number of non-hires.

The remaining labor-related expense issue to be considered is the allowance for pension expense. Both the applicant and the staff annualized pension expense, but applicant has objected to the specifics of the staff's calculation. The staff agreed that a correction was required to the pension accrual rate it had originally proposed, but continued to recommend the use of a rate based on 1981 data rather than the rate proposed by the company (Staff Ex. 7, p. 5). Applicant's witness Chopp explained the development of applicant's proposed rate, which incorporates the results of a new retirement study using 1982 data (App. Ex. 5A, p. 8). The Commission sees no reason why this more current rate, which has been adjusted back to match the test period, should not be preferred. We reject, however, applicant's later proposal to annualize pension expense to year-end 1982 levels (Tr. XV, p. 34, App. Ex. 29A, p. 5). The pension expense allowance should be consistent with the payroll expense allowance authorized.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****Health Insurance Expense:**

Applicant proposed an adjustment to annualize health insurance expense so as to recognize all known premium increases which became effective during the test year (App. Ex. 1B, WPC-3.9, g). The staff recommended approval of the adjustment, subject to appropriate allocation between expense and capital (S.R., p. 7; S.R., Sched. 3.11), and there is now no dispute between the company and the staff with respect to this item (App. Ex. 1D, WPC-3.9, g). Consumers' Counsel objected to the staff's acceptance of the allowance proposed by the applicant, not on the theory that the expense should not be annualized, but on the grounds that the company's 1982 budget estimate for this item was too high. Consumers' Counsel witness Effron proposed an adjustment which would tie the health insurance expense allowance to the actual level of health insurance through the first six months of 1982 (OCC Ex. 1, Sched. OI-4).

The Commission does not believe the health insurance expense adjustment proposed by Mr. Effron to be appropriate. As the Commission has explained on a number of occasions, the mere fact that there is a difference between actual results and forecasted results does not, of itself, justify the use of the actual results in determining allowable expenses. Wholesale substitution of actual results defeats the purpose of the partially-projected test-year, and the use of actual results in only those instances where actual expenditures prove lower than the budgeted expense level is obviously unfair. Thus, it is only when there is a showing that the forecasted numbers are not representative of an applicant utility's ongoing experience that the forecasted expense for the projected months of the test year should not be used in setting rates. We find no such evidence here. Although we agree that the company's

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

1982 budget estimate for health insurance was significantly higher than the company's 1981 experience (OCC Ex. 1, p. 32), this does render the estimate unreasonable. The factors which prompted the company to anticipate an increase of this magnitude have been identified (App. Ex. 19, p. 4; Tr. XI, pp. 52, 54-57), and the staff considered the budget estimate reasonable (Staff Ex. 7, pp. 14-15). Further, as Mr. Effron's own numbers reveal, the total actual health insurance expenditure for the first six months of 1982 was, on an average-monthly basis, within ten percent of the proposed annualized allowance expressed on a monthly basis (OCC Ex. 1, Sched. OI-4). As Consumers' Counsel did not introduce the actual monthly expenditures for the first six months of 1982 into evidence, we have no basis upon which to determine how the timing of various premium increases affected the results of this comparison, but it is obvious that annualizing any premium increase which occurred during this period would have narrowed the gap between the actual expenditures and the allowance proposed by the company and recommended by the staff. Moreover, inclusion of actual data for the final months of the test year may well have moved the results closer still. Consumers' Counsel's objection should be overruled.

**Davis-Besse Refueling Outage:**

The applicant and the staff both included the budgeted cost of the regularly scheduled refueling and maintenance outage at the Davis-Besse nuclear plant in test-year operation and maintenance expense. In prefiled testimony, Consumers' Counsel witness Effron proposed an adjustment to eliminate this expense on the grounds that the next scheduled refueling outage might not occur while the rates established in this proceeding remain in effect (OCC Ex. 1, pp. 38-40). The witness subsequently with-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

drew this recommendation, conceding that it is possible that all or part of the next refueling outage will take place during the period in which the new rates will be in effect (OCC Ex. 1A, pp. 1-2). However, Mr. Effron did recommend that something less than the total budgeted cost of outage be included in cost of service as the annual allowance for this item (OCC Ex. 1A, pp. 2-3). At hearing, staff witness Montgomery testified that a normalizing adjustment of this type had been recommended by the staff in the company's last case, and proposed that the cost of the outage be amortized over a fourteen-month period here as well (Tr. XIII, pp. 129-131). Mr. Effron recommended inclusion of two-thirds, rather than twelve-fourteenths, of the cost (OCC Ex. 1A, p. 3). Consistent with the Commission's findings with respect to this subject in *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982) and *Toledo Edison Company*, Case No. 81-620-EL-AIR (June 9, 1982), we agree that a normalizing adjustment is appropriate to reflect the fact that the interval between scheduled outages is something more than twelve months. The Commission further finds, for reasons stated in those decisions, that the fourteen-month amortization is reasonable. Accordingly, we will reduce the allowable expense associated with the Davis-Besse refueling and maintenance outage by \$894,000.

The regularly scheduled Davis-Besse refueling and maintenance outage which began in March of 1982 actually lasted until September 3, 1982 so that a number of necessary corrections could be accomplished (Tr. X, p. 148). Intervenor City of Cleveland objected to the staff's recommended allowance for a number of different working capital and expense items, contending that the staff's findings failed to adequately reflect the effects of this extended outage on test-year operations. However, as several staff witnesses explained, the outage occurred in

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

the projected portion of the test year, thereby rendering additional adjustments unnecessary (Staff Ex. 7, pp. 18-19; Staff Ex. 3, p. 26). These objections are overruled.

**Nuclear Fuel Disposal Costs:**

The staff accepted applicant's proposed allowance for nuclear fuel disposal costs (Staff Ex. 8, pp. 16-17). Consumers' Counsel objected, contending that the annual Davis-Besse generation used in applicant's calculation assumed a 58 percent capacity factor, a much higher capacity factor than the unit had historically exhibited. Consumers' Counsel witness Effron proposed that a 50 percent capacity factor be used to restate annual Davis-Besse generation, and that this revised generation be used in the calculation of nuclear fuel disposal costs and units-of-production depreciation expense (OCC Ex. 1, pp. 42-45). The Commission does not agree that this adjustment is appropriate, as we cannot conclude, based on the evidence in the case, that the 58 percent factor used by the applicant and the staff is unreasonable. According to Mr. Effron's own testimony, the unit exhibited a 56 percent capacity factor in 1981 (OCC Ex. 1, p. 42). According to staff witness Fox, the unit exhibited an average monthly capacity factor of 73.2 percent for the first four months of the test year, and 73.8 percent for the first six months of the test year (Staff Ex. 3, p. 20). According to applicant's witness Zitzman, the unit produced annual generation in excess of forecasted levels for the twelve months ended January, 1982, and the twelve months ended February, 1982 (Tr. VII, pp. 114-115). Obviously the unit had a zero capacity factor during the months of the extended outage, which drew the actual test year capacity factor far down, but the Commission does not regard this as rendering the Davis-Besse generation as-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

sumed in the four-and-eight case unreasonable for purposes of determining the allowance for nuclear fuel disposal costs. The objection is overruled.

**Contingency Allowance:**

Applicant's 1982 operating budget, from which expenses for the projected months of the test year are developed, includes a power supply contingency component to reflect expenditures which are expected to occur but which cannot be specifically planned for with respect to timing and magnitude (OCC Ex. 1, p. 37). Consumers' Counsel objected to the staff's failure to eliminate this contingency allowance from cost of service and Consumers' Counsel witness Effron has proposed a specific adjustment to accomplish this result (OCC Ex. 1, Sched. OI-8). The Commission does not agree that such an adjustment is appropriate. In the preparation of its budget, the company must obviously allow for a certain level of expense for necessary repair and maintenance projects, although the details of these activities cannot be known in advance. The budgeted amount is based on the historical trend with respect to these expenditures, and the evidence shows that in 1981 the actual expense dollars booked against the contingency exceeded the budget and that this situation has continued through August of 1982 (App. Ex. 29, pp. 6-8). There are two possible approaches. Either the Commission can accept the budget estimate, or it can undertake some normalizing adjustment based on the recent actual experience, which, of course, is what the company intended through the use of the contingency allowance in the first place. The Commission cannot, however, simply ignore these expenses as Consumers' Counsel would have us do. Accordingly, the objection is overruled.

**RCS Program Expense:**

Pursuant to the provisions of the Natural Energy Conservation Policy Act, applicant is engaged in a residential conservation service program (RCS) which entails providing home energy audits, upon request, to its residential customers. The company's proposed allowance for this item of \$297,064 is based on the partially projected test-year costs associated with the program (Tr. III, p. 125). The City of Cleveland objected to the staff's failure to recommend an adjustment to test-year RCS program expense, contending that the allowance proposed by the company is excessive. Based upon a review of the record relative to this subject, the Commission agrees that an adjustment is required.

The use of the test-year RCS expense for purposes of establishing an allowance for this item is inappropriate for two reasons. First, the four-and-eight test-year figure assumed 3,100 audits would be conducted (Tr. XIV, p. 49; App. Ex. 18). In fact, only 121 such audits were actually performed (Tr. III, p. 127). This is not an instance where the budgeted expense affords a more representative basis upon which to fix rates than does the actual experience, for the company now anticipates that it will be called upon to undertake only 250 home energy audits in 1983 (Tr. XIV, p. 50). Thus, the variable program costs should be recalculated for cost of service purposes using the more reasonable 250 audit assumption (Tr. XIV, pp. 57-58, App. Ex. 18). Second, the test-year RCS program expense contains certain fixed costs which, for ratemaking purposes, should not be regarded as representative of the annual level of the fixed costs associated with the programs. Although the company is required to notify its customers of the availability of the program, it makes this special mailing only once every two years.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Therefore, only half of the fixed costs of the announcements and the mailing should be included as an allowable annual expense. At hearing, applicant's witness Blank proposed a calculation which the Commission believes properly normalizes both the variable and fixed costs associated with RCS program expense (Tr. XIV, pp. 46-58; App. Ex. 18). Accordingly, the Commission finds the result of this calculation, or \$79,400, to be the proper allowance for RCS program expense item for purposes of this case.

**Advertising Expense:**

Applicant proposed an allowance for advertising expense in the amount of \$2,334,129 (App. Ex. 1B, Sched. C-8). The staff, in applying the standards for allowable advertising expense set out in *City of Cleveland v. Public Utilities Commission*, 63 Ohio St.2d 62 (1980) and *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR, Order on Rehearing (January 21, 1981), excluded all general advertising expenses (Account 930) and a portion of the expense charged to information and institutional advertising (Account 909), resulting in a total reduction in the advertising allowance of \$1,221,390 (S.R., p. 8; S.R., Sched. 3.13). As usual, the company claims that there should be no adjustment (App. Ex. 5A, pp. 13-14), while intervenors argue that the staff has not gone far enough (OCC Ex. 1, p. 35; OCC Ex. 11, OCC Ex. 12; City of Cleveland Ex. 4, City of Cleveland Ex. 5).

In addition to its general objection to the exclusion of any advertising expenditures, which, of course, we shall overrule, applicant has specifically objected to the exclusion of costs associated with certain ads which the staff and the Commission did not exclude in applicant's last case, *Cleveland Electric Illuminating Company*, Case No.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

81-146-EL-AIR (March 17, 1982). As we have noted on prior occasions, legitimate differences of opinion may exist as to the primary thrust of a given ad. Thus, we are not particularly surprised that different members of the staff might reach different conclusions regarding the same ad. However, upon review of those ads included by the staff in the prior case but excluded here (App. Ex. 5A, Appendix IV), the Commission is of the opinion that the costs are properly includable under the *City of Cleveland, supra*, tests. Although certain of the ads do, in a sense, promote electricity for home heating purposes, the primary message is to inform customers of measures which may be taken to use electricity more efficiently. The cost of the ads, or \$55,701 (App. Ex. 5A, p. 14), should be restored to the advertising expense allowance.

Applicant has also objected to the staff's exclusion of \$244,212 for collateral ads as a part of its recommended advertising expense adjustment (S.R., Sched. 3.13). These ads, which include energy management pamphlets, brochures, and other printed material, were also included in the advertising expense allowance in the company's last case (App. Ex. 5A, p. 15; App. Ex. 5A, Appendix V; App. Ex. 21). These ads are clearly informational in nature, but were apparently excluded by the staff on the grounds that not all customers could benefit from the messages conveyed (Tr. XI, pp. 37-43). The Commission has held that this is not a particularly relevant consideration in determining whether an ad satisfies the standards for inclusion (*Dayton Power and Light Company*, Case No. 81-21-EL-AIR [February 3, 1982]). Indeed, such a test would require the exclusion of ads advising of the availability of energy assistance programs. Thus, the Commission finds that the costs of these collateral ads should be recognized in the allowance for advertising expenses.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Consumers' Counsel objected to the staff's failure to allocate a portion of Account 909 labor expense to the ads it excluded and to eliminate the amount from cost of service (OCC Ex. 1, p. 35). However, as staff witness Hess testified, this labor expense is in the nature of a fixed cost which would be incurred whether or not ads were excluded (Staff Ex. 7, p. 18). Consumers' Counsel witness Effron agreed that the costs were not variable (Tr. XII, p. 72). This objection is overruled.

At hearing, intervenors Consumers' Counsel and the City of Cleveland introduced certain television (OCC Ex. 11), radio (City of Cleveland Ex. 4), and newspaper (OCC Ex. 12) advertisements run by the company during the test year which describe the advantages of electric heat pumps. Intervenors argue that the cost associated with these ads should also be excluded on the grounds that the ads are promotional. City of Cleveland has offered certain ads excluded by the Commission in *East Ohio Gas Company*, Case No. 81-970-GA-AIR (August 4, 1982), in an effort to show some parallel with the Cleveland Electric Illuminating Company ads in question here (City of Cleveland Ex. 5). Applicant's heat pump ads all stress the energy and cost saving attributes of various types of heat pumps, and the Commission has previously found that ads of this type are properly considered to be informational in character (*Toledo Edison Company*, Case No. 80-377-EL-AIR [April 9, 1981]). Although we share applicant's concern as to the probative value of the ads identified by intervenor as having been excluded in the *East Ohio Gas Company* case, *supra*, we agree that there are readily discernible differences between those ads and the ads intervenor would have us exclude in this case (App. Br., pp. 27-28). We believe that the staff's proposed adjustment, subject to the modifications discussed above,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

results in an allowance for advertising expense which is consistent with the *City of Cleveland, supra*, standards.

The City of Cleveland also objected to the staff's failure to exclude the costs associated with applicant's Speakers' Bureau and its sponsorship of certain television programs. The Speakers' Bureau costs, which have been identified as the allocated labor cost for two employees responsible for scheduling and setting up programs, have been included in prior cases (App. Ex. 29, p. 4). The Commission continues to believe that it is appropriate that the company maintain this service so as to respond to requests for presentations on energy matters and will recognize this cost in determining allowable expenses (*See also Ohio Edison Company*, Case No. 80-14-EL-AIR [February 11, 1981]). The evidence indicates that the "sponsorship" of the television programs alluded to in the City's objection involves no costs other than Account 909 or Account 930 advertising expenses which have already been examined (App. Ex. 29, p. 4; Tr. XV, p. 108). This objection is overruled.

**Lobbying Expense:**

Consumers' Counsel objected to the staff's failure to eliminate certain public and governmental affairs expenses from test-year operating expenses. However, at hearing, Consumers' Counsel witness Effron withdrew the adjustment he had initially proposed for these items, having determined that the expenditures in question had not been included in cost of service by either the company or the staff (OCC Ex. 1A, p. 1). The City of Cleveland also objected to the staff's failure to eliminate expenses relating to lobbying activities, but presented no evidence that any lobbying expenses were included in the test-year expense allowance recommended by the staff. Both objections should be overruled.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****OEUI and EEI Payments:**

Intervenor City of Cleveland objected to the staff's failure to exclude all payments to the Ohio Electric Utilities Institute and the Edison Electric Institute from allowable expenses. As the Commission has consistently held, and as staff witness Hess testified in this case, dues to those organizations constitute normal business expenses and should be recognized in cost of service (Staff Ex. 7, p. 20). Further, test-year payments to these organizations for lobbying expenses and institutional advertising have been excluded by the staff in developing allowable test-year expenses (Tr. III, pp. 121-122; Staff Ex. 7, p. 20). The objection should be overruled.

**Charitable Contributions:**

Consistent with the Supreme Court's decision in *Cleveland v. Public Utilities Commission*, 63 Ohio St.2d 62 (1980), and this Commission's interpretation of that decision as set out in *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR, Order on Rehearing (January 21, 1981), the staff reversed applicant's proposed reclassification of test-year charitable contributions to operating expenses (S.R., p. 8; Staff Ex. 7, 9). The company objected, but did not pursue the matter at hearing or on brief. The objection is overruled.

**Annualization of Accounting Change:**

As indicated in our earlier discussion of Consumers' Counsel's proposed rate base adjustment for this item, the Commission, consistent with the staff's recommendation (Staff Ex. 8, p. 6), will accept the adjustment proposed by the company to reflect the change in its accounting procedure for allocating supervision and overhead clearing

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

accounts between expense and property (App. Ex. 1D, Sched. 3.18).

**Breeder Reactor Corporation Payments:**

The Commission has also indicated that although no rate base deduction for accrued Breeder Reactor Corporation payments is appropriate, Consumers' Counsel witness Effron's recommended adjustment to eliminate the budgeted payments from allowable test-year expenses will be approved (OCC Ex. 1A, pp. 3-4).

**Terminated Nuclear Units:**

In *Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St.2d 153 (1981), the Supreme Court of Ohio held that, under Ohio law, a utility's investment in generating facilities which are cancelled prior to completion is not properly includable as an allowable operating expense for ratemaking purposes. This case represented an appeal from this Commission's decision in *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR (July 10, 1980) in which the Commission had permitted applicant to amortize its share of the costs associated with the cancellation of four nuclear generating units over a reasonable period and to include the annual amount in cost of service. Applicant has, in this case, again requested that the annual amortization be recognized as an allowable expense (App. Ex. 5A, pp. 1-2), and has objected to the staff's failure to recommend approval of the adjustment (S.R., pp. 8-9; Staff Ex. 7, p. 8). The Commission agrees with its staff that the *Consumers' Counsel* decision, *supra*, precludes this expense adjustment and must overrule this objection. As discussed *infra*, applicant will be permitted to continue the annualization for book accounting purposes.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****Antitrust Expense:**

Consumers' Counsel and the City of Cleveland objected to the staff's failure to adjust test-year expenses to exclude a portion of the costs incurred by the company in connection with its defense of antitrust actions. Although the Commission has consistently held that costs of this type should be regarded as reasonable and necessary business expenses for ratemaking purposes, the level of expense recognized must also be reasonable (*See, e.g., Ohio Bell Telephone Company*, Case No. 81-1433-TP-AIR [December 22, 1982]). Intervenors argue that applicant's test-year antitrust expense was abnormally high and does not represent an appropriate basis upon which to establish an allowance for this item. The Commission must agree. The evidence indicates that the \$1,101,000 in antitrust costs included in test year expenses relate, at least primarily, to the company's defense of the civil antitrust action brought by the City of Cleveland (Tr. III, pp. 77, 125). The trial in the antitrust case, which resulted in a verdict for the company, was still in progress during the early months of the test year, and the test-year expenditures so reflect. Indeed, \$961,000 of the total related to the four actual months of the test year, with the remaining \$140,000 representing the budgeted amount for the balance of the test year (Tr. III, pp. 77-78). Although we would agree with applicant that the costs associated with this case should be regarded as recurring in that the matter is now on appeal, this does not speak to the question of whether such costs will be incurred at the test year level in the future. Applicant's budget for the forecasted months of the test year, its budget for 1983, and the testimony of its own witness all support the conclusion that they will not (Tr. III, pp. 78-79, 124-125). Thus, we will accept the adjustment proposed by Consumers' Counsel witness Effron to normalize

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

test-year antitrust expense (OCC Ex. 1, p. 36), and will reduce the allowance for this item by \$877,000 (OCC Ex. 1, Sched. OI-7). We reject the City of Cleveland's alternative argument that none of these costs should be considered jurisdictional for purposes of this case.

**Rate Case Expense:**

Applicant initially estimated the expenses associated with the preparation, filing, and prosecution of this rate case at \$380,000 (App. Ex. 1B, Sched. C-9). Based on the information available at the time of its investigation, the staff recommended that this estimate be recognized as the appropriate annual allowance for rate case expense (S.R., p. 9; S.R., Sched. C-9). In addition to its usual objection to the inclusion of any allowance for rate case expense, which, as usual, we shall overrule, Consumers' Counsel also objected to the inclusion of any in-house expenses in the rate case expense estimate. The Commission, of course, agrees that in-house costs may not properly be included as both rate case expense and as other operating expenses, but there has been no evidence of any such double-counting here (Staff Ex. 4 p. 8). The City of Cleveland objected to the one-year write-off recommended by the staff, arguing that some longer amortization period may be appropriate in light of the fact that the company has not yet filed another rate case. However, based on applicant's recent filing history, we believe the inclusion of the expenses associated with this case as the annual allowance for rate case expense to be eminently reasonable.

Pursuant to a standing staff data request and the directive of the presiding examiner, applicant submitted a revised rate case expense exhibit subsequent to the close of the hearings which shows actual costs incurred to date and estimated costs to completion. The revised estimate is \$275,606.43 (App. Ex. 31). It is the Commission's general

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

practice to review the late-filed rate case expense exhibit as a check on the reasonableness of the initial estimate, and, in instances where the late-filed exhibit indicates rate case costs lower than original estimate, to use the revised rate case expense figure as the basis for the allowance (*Dayton Power and Light Company*, Case No. 81-21-EL-AIR [February 3, 1982]). Consumers' Counsel and City of Cleveland both argue that the Commission should not accept the revised rate case expense exhibit as evidence of a reasonable allowance without some adjustment to exclude the estimated costs of an appeal from the Commission's decision. We are hard pressed to understand how intervenors can contend that the costs of an appeal should not be regarded as a proper component of the allowance for rate case expense in the face of this company's track record. As multiple appeals have been taken from this company's last four rate orders, the cost of appeal cannot be regarded as an extraordinary or non-recurring expense. Moreover, contrary to the impression intervenors have attempted to leave, it is not applicant's litigious nature which has spawned all these appeals. Indeed, as chronicled in applicant's brief, these very intervenors have been responsible for far more of these journeys to the Supreme Court than has the company (App. Br., pp. 31-33). Given the record and this history, the Commission finds that the revised rate case expense estimate submitted by the company represents a reasonable allowance for rate case expenses for purposes of this proceeding.

**Purchasing Activities:**

Intervenor City of Cleveland objected to the staff's failure to review the reasonableness of applicant's purchasing activities and to determine whether appropriate competitive bidding procedures and other cost checks had been employed by the company. Staff witness Fox re-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

sponded to this objection, indicating that the staff had reviewed applicant's purchasing activities, including its competitive bidding practices, and found them to be proper (Staff Ex. 3, p. 27). As intervenor's counsel did not cross-examine Mr. Fox with respect to this testimony, one might logically have concluded that this would end the matter. However, on brief (City of Cleveland Br., p. 42), intervenor seizes the occasion to assail the Commission for "cavalierly" dismissing a similar City of Cleveland objection in its recent decision in *East Ohio Gas Company*, Case No. 81-970-GA-AIR (August 4, 1982). The circumstances here are identical to those presented in *East Ohio*, *supra*. Intervenor has again offered absolutely nothing in the way of argument or evidence which would in any way suggest that applicant has acted imprudently in its purchasing activities. If intervenor regards it as "cavalier" to dismiss an objection without pages of discussion where the objection has not been pursued at hearing and, thus, has no bearing on the results in a case, we apologize, but this makeweight objection is again overruled.

**Depreciation Expense:**

Consistent with the Commission's customary practice, the staff determined its recommended allowance for depreciation expense by applying the approved accrual rates to date-certain depreciable property (S.R., Sched. 9.2). Applicant objected and, through its witness Szwed, argued that year-end property levels should be used in this calculation (App. Ex. 10, pp. 6-7). The Commission disagrees. Although applicant characterizes its proposal as a normalizing adjustment, the fact is that it is the staff's method which produces the proper match between rate base and expense (Staff Ex. 3, pp. 4-7). The objection is overruled.

The City of Cleveland objected generally to the use of the units-of-production depreciation method for calcula-

### **Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

ting depreciation expense associated with Davis-Besse. This is a matter we thought had been resolved some years ago (*See Determination of Depreciation Charges*, Case No. 77-1369-EL-UNC, Order on Rehearing [December 12, 1979]; *Toledo Edison Company*, Case No. 79-143-EL-AIR [February 29, 1980]; *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR [May 1, 1981]), and we find nothing in intervenor's argument which would persuade us to reexamine this question at this time. The objection is overruled.

Both Consumers' Counsel and the City of Cleveland objected to the allowance for Davis-Besse depreciation expense proposed by the company and recommended by the staff, contending that the calculation assumed an annual capacity factor above that supported by the unit's historical performance. Our earlier discussion with respect to Davis-Besse nuclear fuel disposal costs is dispositive of this issue as well. These objections are overruled.

### **PUCO and OCC Maintenance Assessments:**

For book accounting purposes, applicant charges its annual PUCO and OCC maintenance assessments to operation and maintenance expense. As a part of its test year analysis, the staff, consistent with its customary practice and with long-standing Commission precedent, reclassified these assessments as "other taxes" (S.R., p. 8; S.R., Sched. 3.16 and 3.22). Applicant has again objected to the reclassification, contending that the Uniform System of Accounts requires that these payments be charged to Account 928 — Regulatory Commission Expenses (App. Ex. 5A, pp. 15-17). The assessments are, of course, recognized in allowable expenses under either treatment, but the classification of the assessments as tax expense rather than operation and maintenance expenses does affect the results of the working capital calculation. As suggested above, the Commission

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

has consistently considered the assessments as taxes for ratemaking purposes, and applicant has offered nothing in the instant case which would persuade us to alter that view (See, e.g., *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980], p. 26; *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR [May 1, 1981], pp. 20-21). This objection should be overruled.

Applicant has also objected to the staff's use of the 1981 PUCO and OCC maintenance assessments on the basis of the allowance for these items, contending that the actual 1982 assessments should be utilized (App. Ex. 9A, p. 5). It is apparent that the 1982 assessments were not yet known at the time of the staff's investigation, but as the amounts have now been supplied to the record, the Commission agrees that they should be recognized as the basis of the allowance for the PUCO and OCC maintenance assessments for purposes of this proceeding (App. Ex. 29, p. 11).

**Property Tax:**

Applicant objected to the staff's failure to use an estimated year-end 1982 tax rate in calculating its recommended allowance for property tax expense. As staff witness Hess testified, the allowance for property taxes should be based on the latest known tax rate, not on an estimated rate (Staff Ex. 7, p. 13). Mr. Hess agreed, however, that the property valuation reflected in the staff's calculation should be revised in order to recognize the final assessed valuation of the company's December 31, 1981 property as fixed by a Department of Taxation valuation notice issued subsequent to the Staff Report (Staff Ex. 7, p. 13; App. Ex. 9A, pp. 2-3). The Commission so finds. Prior to the conclusion of the hearings in this case, the fate of a number of property tax levies which were on the ballot in the November elections became known, and applicant has proposed

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

that these results be incorporated in the property tax calculation (App. Ex. 29, p. 5; App. Ex. 29A, pp. 1-3). Consistent with the well-settled principle that all known tax charges should be recognized in determining allowable expenses, the Commission will accept the proposed adjustment.

**Unemployment Taxes:**

Applicant objected to the staff's failure to recognize the increase in federal and state unemployment taxes which will result from recent federal legislation (TEFRA) providing for a higher unemployment tax rate and taxable base wage level (App. Ex. 9A, pp. 4-5). Staff witness Hess agreed that an adjustment was required to recognize this known change, but recommends that the adjustment be calculated using the test-year average number of employees rather than the year-end employee level as proposed by the company (Staff Ex. 7, pp. 11-12). The Commission is of the opinion that the employee level used in this calculation should be consistent with that used in the determination of other labor-related expenses, and will accept Mr. Hess's recommendation.

**FICA Tax:**

The staff calculated its recommended allowance for FICA tax expense by developing an effective FICA tax rate and applying that rate to its recommended annualized labor expense (S.R. Sched. 3.22c). Applicant objected, pointing out an error in the method used by the staff to develop the effective FICA rate (App. Ex. 5A, p. 9). Staff witness Hess agreed that a correction was required and accepted the revised effective rate supplied by the company (Staff Ex. 7, p. 13). However, just prior to the conclusion of the hearings, the Social Security Administration

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

announced a change in the maximum taxable wage base, raising the base from \$32,400 to \$35,700 (Tr. XV, pp. 32-33). Applicant computed a new effective FICA tax rate which incorporated the effect of this known tax change and submitted the new rate on the last day of hearing (App. Ex. 29A, p. 4; Tr. XV, p. 33). The Commission will use this revised effective rate in determining the allowance for FICA tax expense.

**Ohio Gross Receipts Tax:**

Applicant objected to the staff's calculation of the allowance for the Ohio Gross Receipts Tax on what we perceive to be two separate grounds. The first issue raised, the question of whether the staff calculation annualized the tax at the appropriate rate, has been resolved by the Commission's order in Case No. 82-1268-AU-UNC providing for a revision in the excise tax recovery mechanism (Staff Ex. 8, p. 5). The second issue, the question of whether an additional allowance should be established in this base rate proceeding to reflect the fact that the operation of the excise tax surcharge generates additional excise tax liability, has not been pursued by the company on brief (Tr. II, pp. 30-32). The Commission addressed this question in *Dayton Power and Light Company*, Case No. 81-21-EL-AIR (February 3, 1982), finding that the issue might more appropriately be considered a subject for the generic docket and that no adjustment should be made in the context of the rate case. The Commission adheres to this view and will overrule the objection.

**Pennsylvania Gross Receipts Tax:**

Pursuant to a change in Pennsylvania law effective January 1, 1980, applicant is no longer subject to a Pennsylvania gross receipts tax (Tr. II, p. 58). Prior to that

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

statutory change, the company had been involved in a dispute with the Commonwealth concerning its liability for that tax (App. Ex. 9, p. 3). The controversy was settled in December of 1981 and applicant adjusted test year expenses to remove the effects of the settlement and an associated book accrual reversal from cost of service (App. Ex. 9, p. 3; App. Ex. 1B, Sched. C-3.11). Consumers' Counsel, through a filed objection, argued that the staff should have recommended a refund to ratepayers on the theory that applicant had, through past rates, collected amounts for the Pennsylvania gross receipts tax liability which it had not, in fact, ultimately been required to pay. However, as staff witness Montgomery testified, no adjustment is required as the tax was not reflected in the rates in effect during the test year (Staff Ex. 8, p. 17). Indeed, applicant has indicated that it would be happy to refund the amount in question if, at the same time, it were authorized to collect additional amounts to reflect those instances where the actual expenses proved to be greater than the levels upon which rates had been based (Tr. II, p. 60). This Consumers' Counsel objection mistakes the nature of the rate-making process and should be overruled.

**Pennsylvania Corporate Net Income Tax:**

Although the staff included an allowance for the Pennsylvania Corporate Net Income Tax in cost of service (S.R., Sched. 3.22g), the staff did not annualize the tax on an adjusted test-year basis or recognize the tax in the calculation of the gross revenue conversion factor. Applicant objected on both counts (App. Ex. 9A, pp. 1-2; App. Ex. 6A, pp. 7-8). At hearing, staff witness Montgomery agreed that the tax should be annualized and that its impact should be reflected in the gross revenue conversion factor (Staff Ex. 8, pp. 4, 8). The Commission, noting that this measure is consistent with the treatment accorded

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

this item in *Ohio Edison Company*, Case No. 81-1171-EL-AIR (November 3, 1982), will accept both adjustments.

**Federal Income Tax:**

Although the staff's proposed allowance for federal income tax expense was the subject of several objections, a number of these issues were resolved at hearing. Staff witness Montgomery agreed that certain clerical errors identified by applicant's witness Jirousek (App. Ex. 9A, p. 9) and Consumers' Counsel witness Effron (OCC Ex. 1, p. 46) should be corrected (Staff Ex. 8, pp. 5-6, 18-19), and further agreed that the staff's tax calculation failed to recognize certain credits to deferred taxes which should have been included as reconciling items (App. Ex. 9A, pp. 9-10; OCC Ex. 1, pp. 52-53; Staff Ex. 8, pp. 6, 17-18). Mr. Montgomery disagreed, however, with the correction proposed by applicant for one of these latter items, nuclear plant decommissioning, and supplied his own revision (Staff Ex. 8, p. 6), which the company has agreed is appropriate (Tr. XIII, p. 134). These matters are no longer in dispute, and the Commission will incorporate the above revisions in its calculation of the allowance for federal income tax expense.

As indicated in our earlier discussion of the rate base deduction for deferred taxes, applicant has proposed inter-period tax allocation for the deduction associated with employee benefits capitalized (App. Ex. 1B, Sched. C-5). The staff has recommended that normalization be permitted for this item (S.R., p. 10; Staff Ex. 8, p. 18). Consumers' Counsel witness Effron did not oppose deferred tax accounting for this timing difference, but suggests that his position on this issue would be influenced by whether or not Perry Unit No. 1 is recognized in the construction work in progress allowance (OCC Ex. 1, p. 54). As the Commis-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

sion held in *Ohio Bell Telephone Company*, Case No. 81-436-TP-AIR (April 21, 1982), considerations of this type are not particularly relevant for purposes of determining whether normalization should be approved. The staff's recommendation will be accepted.

The final issue in this area involves the treatment to be accorded the net rent deduction associated with the two tax benefit transfers the company entered into in late 1981. As our discussion with respect to the rate base effect of these transactions indicates, the Commission has determined that all tax benefits associated with the transfers should be normalized for ratemaking purposes (*See Ohio Edison Company*, Case No. 81-1171-EL-AIR [November 3, 1982]). However, a question remains as to the mechanics of the interperiod allocation.

Under the sale and lease-back agreements, applicant's annual rental payment as lessee is offset by the annual loan payment made by the buyer. The rental payments, of course, represent a tax deduction, while the interest component of the loan payment constitutes taxable income. Because the portion of the loan payment regarded as a return of principal is not regarded as taxable income, a tax benefit, termed the net rent deduction, is created. The interest component of the annual rental payment continues to decrease over the 15-year life of the lease, thereby resulting in a corresponding increase in the net rent deduction.

The applicant and the staff propose to normalize the net rent deduction by annually recording deferred taxes in an amount equal to that year's deduction and by then amortizing the accumulated deferred taxes over the remaining life of the subject property (App. Ex. 9A, p. 7; Staff Ex. 8). Consumers' Counsel, on the other hand, would quantify the total net rent tax benefit associated with the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

subject property and divide by its 30-year life so as to provide an equal benefit in all years (OCC Ex. 1, pp. 49-51). Consumers' Counsel witness Effron complains that the method recommended by the company and the staff results in future customers enjoying a significantly greater proportion of the total tax benefit than current customers (OCC Ex. 1, p. 49). Although this may be true, such a result is not quite as inequitable as intervenor would have us believe, for the tax benefits are, in fact, significantly greater in the later years of the lease.

The Commission would agree that the goal of inter-period tax allocation is to spread the tax savings attribute of property over its total life so that all customers served by the property may participate in the associated tax benefits (Tr. XIII, p. 113; *See also Dayton Power and Light Company*, Case No. 76-88-GA-AIR [July 22, 1977]). However, the Commission cannot agree that this principle can be extended so as to permit customers to share in tax benefits in advance of the time that the Company actually realizes them. In so stating, we are not unmindful of intervenor's argument that this is the result which obtains in connection with the ratemaking treatment for the tax deduction associated with nuclear plant decommissioning costs (OCC Br., pp. 51-52). However, the Commission finds the analogy inopposite. In the case of nuclear plant decommissioning costs, the tax effect must track the booking of the expense so that the customers who are currently paying for that future cost will receive the benefit of the deduction rather than the customers who happen to be on line when the decommissioning expenditure actually occurs. In the case of the tax benefit transfer net rent deduction, there is no such book/tax relationship. We are not dealing with a one-time future tax deduction which is the product of a one-time future expenditure that is pres-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

ently being amortized to cost of service. Rather, the net rent deduction represents a series of benefits in which customers should not participate at a rate faster than that at which they actually become available to the company. Consumers' Counsel's proposal would, in the early years, give customers the benefit of a deduction greater than that realized by the company, thereby creating a negative cash flow and an increase in rate base, results which are totally at odds with those expected under normalization. The normalization method recommended by the applicant and the staff will be accepted for purposes of computing the allowance for federal income tax expense in this case.

**Allowance for New Taxes:**

Applicant proposed an adjustment of some \$11.5 million to test-year tax expense to provide an allowance for any new taxes or tax increases which might be enacted prior to the conclusion of this proceeding and for which no other collection mechanism is provided (App. Ex. 1, Sched. C-3.6; App. Ex. 9, p. 3). However, as applicant's witness Jirousek acknowledged at hearing, no new taxes or tax increases of the type contemplated by the adjustment have materialized (Tr. II, pp. 55-56). The staff properly rejected this adjustment (S.R., p. 9), and applicant's objection to the staff's exclusion of the proposed allowance should be overruled.

**Operating Income Summary:**

Consistent with the foregoing discussion, the Commission finds applicant's jurisdictional adjusted operating income for the twelve months ending August 31, 1982, the test period in this proceeding, to be as set forth in the following schedule:

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR****Adjusted Operating Income**  
(000's Omitted)

Operating Revenues .....	\$1,201,906
Operating Expenses	
Operation and Maintenance .....	660,831
Depreciation and Amortization .....	84,547
Taxes Other than Income Taxes .....	116,376
Income Taxes .....	109,188
Total Operating Expenses .....	<u>\$ 970,942</u>
Net Operating Income .....	<u><u>\$ 230,964</u></u>

**PROPOSED INCREASE**

A comparison of jurisdictional operating revenues of \$1,201,906,000 with allowable jurisdictional expenses of \$970,942,000 indicates that under its present rates, applicant realized income available for fixed charges in the amount of \$230,964,000 based on adjusted test-year operations. Applying this dollar return to the jurisdictional rate base of \$2,198,419,000 results in a rate of return under present rates of 10.51 percent. This rate of return is well below that recommended as reasonable by any of the expert witnesses presenting testimony on the subject and, accordingly, the Commission must conclude that the company's present rates are insufficient to provide it reasonable compensation for the service rendered customers affected by the application. Rate relief is clearly required at this time.

Under the rates proposed by applicant, additional gross annual revenues of \$233,262,000 would have been realized based on test-year operations as analyzed herein (S.R., Sched. 1). On a *pro forma* basis, which assumes necessary expense adjustments calculated in a manner consistent with the Commission's findings, the proposed

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

increase would have yielded an increase in jurisdictional net operating income of \$113,169, resulting in income available for fixed charges of \$120,093. Applying this dollar return to the jurisdictional rate base results in a rate of return of 15.97 percent. Although it is apparent that present rates are inadequate, the increase proposed results in a rate of return in excess of that recommended as reasonable by any of the expert witnesses. Thus, further analysis is required to establish a reasonable earnings opportunity for this company.

**RATE OF RETURN**

Three witnesses presented cost of capital analyses to be considered as evidence by the Commission in establishing a fair rate of return for purposes of this case. Applicant's witness Maugans determined the cost of capital to the company to be in the range of 13.26 to 13.65 percent (App. Ex. 4B), while applicant's witness Jeffries recommended a range of 12.92 to 13.49 percent (App. Ex. 8A, Rev. Ex. FEJ-13). Staff witness Farrar, as a result of his study, found the overall cost of capital to be from 12.17 to 12.59 percent (Staff Ex. 1, p. 23).

**Capital Structure:**

Absent special circumstances, an applicant utility's latest known capital structure must be employed in the cost of capital analysis if the results are to be considered a reliable measure of the cost of capital to the company (See, e.g., *Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979]; *Ohio Edison Company*, Case No. 78-1567-EL-AIR [January 30, 1980]). Consistent with this principle, Mr. Maugans and Mr. Farrar updated their respective analyses to reflect recent changes in the company's capitalization ratios (App. Ex. 4A, pp. 1-2,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Staff Ex. 1, pp. 2-3). For purposes of their prefiled testimony, both witnesses utilized applicant's August 31, 1982, capital structure, adjusted to include forecasted September results and the effect of a planned October common stock sale (App. Ex. 4A, p. 31; Staff Ex. 1, p. 23). At hearing, Mr. Maugans offered a further update which depicted the actual capital structure as of September 30, 1982, adjusted to reflect the net proceeds from the October 4, 1982 common stock offering (App. Ex. 4B; Tr. VIII, pp. 39-40). The Commission is of the opinion that the resulting capital structure of 47.02 percent long-term debt, 13.82 percent preferred stock, and 39.16 percent common equity now proposed by Mr. Maugans should be adopted for purposes of the cost of capital determination in this case. Mr. Jeffries relied on the capitalization ratios originally supplied by the applicant in arriving at his overall cost of capital recommendation (App. Ex. 8A, Rev. Ex. FEJ-13). Adjusting Mr. Jeffries' analysis by substituting the updated capitalization ratios adopted herein would increase Mr. Jeffries' overall cost of capital recommendation to a range of 13.05 to 13.65 percent. A similar adjustment to Mr. Farrar's calculation produces no material change in his recommended range.

**Cost of Debt and Preferred Stock:**

Although applicant, through its filed objections, took issue with Mr. Farrar's use of the embedded cost of debt and preferred stock in determining the weighted cost of capital to the company, its own witnesses also utilized the embedded costs of these senior securities as the cost rates to be assigned to the long-term debt and preferred stock components of the capital structure (App. Ex. 4A, pp. 28-30; App. Ex. 8A, Rev. Ex. FEJ-13). Accordingly, these objections should, again, be overruled (*See, e.g., Cleve-*

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

*land Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]; *See also In Re Cincinnati Gas and Electric Company*, 11 PUR 4th 257 [1975]). No dispute exists as to the actual embedded cost of debt and preferred and preference stock, and, consistent with the witnesses' recommendations, the Commission finds the embedded cost of long-term debt to be 9.60 percent and the embedded cost of preferred and preference stock to be 9.43 percent (App. Ex. 4B; Staff Ex. 1, p. 23).

**Cost of Common Equity:**

The cost of debt and preferred stock can readily be computed, but the cost to be assigned the equity component of the capital structure can only be estimated. There are a number of valid approaches which may be followed in arriving at such an estimate, and the Commission has, over the years, been called upon to consider many different methods for determining the appropriate return on equity. In this case, however, the analysis required is a relatively narrow one, for the equity cost recommendations sponsored by the rate of return witnesses have all been derived, in whole or in part, through the discounted cash flow methodology, the technique traditionally favored by the Commission. The Commission's deliberations with respect to this subject have been further simplified by the fact that we are dealing here with presentations which are very similar to those offered by these same witnesses in the company's last several rate proceedings. Indeed, as the following discussion will indicate, the only major issue in this area is the determination of the appropriate growth factor to be used in the DCF formula. The difference between Mr. Maugans' equity cost recommendation of 19 to 20 percent (App. Ex. 4A, p. 3), Mr. Jeffries' 18.5 to 20 percent (App. Ex. 8A, p. 2), and Mr. Farrar's 16.22

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

to 17.29 percent (Staff Ex. 1, p. 6) is essentially a function of the differences in their respective growth estimates.

Under the DCF formula, the cost of equity equals the sum of the current dividend yield and the expected rate of growth in dividends (S.R., pp. 39-42). As in the company's last two rate proceedings, applicant's witness Maugans has elected to use a version of the DCF equation which incorporates a future selling price variable (App. Ex. 4, pp. 5-6). The Commission has expressed its reservations concerning Mr. Maugans' model in both those cases, and continues to believe that the introduction of assumptions as to holding periods and price at time of divestment to be inappropriate from a theoretical standpoint (*Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]; *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR [May 1, 1981]). However, as staff witness Farrar points out, the disparity between the cost of equity proposed by Mr. Maugans and that recommended by the staff is not attributable to the differences in the equations used by Mr. Maugans and the staff, but rather to the different estimates of growth which have been employed (Staff Ex. 1, pp. 12-14). This fact, coupled with the fact that applicant's other rate of return witness, Mr. Jeffries, did not find the use of a future selling price variable essential to his DCF analysis, leads the Commission to conclude that further discussion of the point is unnecessary.

Although differences exist as a result of the use of different data bases, there is no real dispute as to the yield component of the formula. Yield is, of course, determined by dividing the common stock dividend by the price. Consistent with the Commission's customary practice, all three witnesses recommended that the price used be the average price for the most recent twelve-month period for which information is available (App. Ex. 4A,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

p. 3; App. Ex. 8A, p. 3; Staff Ex. 1, p. 3). At hearing, Mr. Farrar reported the average price for the twelve-month period ending October, 1982 to be \$16.6198 per share (Staff Ex. 1, p. 3). This updated figure reflected a marked improvement in the price of applicant's common stock from the time applicant's witnesses filed their initial testimony (App. Ex. 4, p. 6; App. Ex. 8, Ex. FEJ-10). Mr. Jeffries did reduce the lower bound of his equity recommendation from 19 to 18.5 percent for purposes of his supplemental testimony to reflect the reduced yield requirements through August of 1982, but Mr. Maugans did not revise his recommendation at all (App. Ex. 8A, pp. 3-5; App. Ex. 4A, p. 3; *See also* Staff Ex. 1, pp. 8-9). Mr. Farrar found Mr. Maugans' failure to revise his recommendation curious in light of the significant reduction in interest rates over the period (Staff Ex. 1, pp. 8-9). We agree, particularly given Mr. Maugans' previous testimony concerning the sensitivity of utility stock prices to changes in interest rates (*Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]). In any event, no party has challenged the use of the price now proposed by staff witness Farrar, nor has there been any objection to the use of \$2.28, the current annualized dividend, as the numerator in the yield element of the formula (Staff Ex. 1, p. 3). Dividing the dividend by the price results in a dividend yield of 13.72 percent which the Commission finds to be the appropriate value for the yield component of the DCF formula.

As indicated at the outset of this discussion, the rate of return controversy in this case centers on the growth estimate to be used in the DCF model. Mr. Maugans proposes a growth value of 5.4 percent (App. Ex. 4A, p. 21), while Mr. Jeffries, although citing factors he believes would support a higher growth estimate, recommends, as a minimum, a range of 4.0 to 4.5 percent (App. Ex. 8A,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

p. 4). Staff witness Farrar found 2 percent to be a reasonable growth estimate (Staff Ex. 1, pp. 4-5). In evaluating these growth estimates, several points must be kept in view. First, the "growth" element of the DCF formula actually represents "expected growth," a quantity not susceptible to empirical measurement. Thus, judgment is involved in arriving at a growth estimate, and legitimate differences of opinion may exist as to what constitutes the best evidence upon which to base that judgment. Second, although the "g" value in the DCF equation relates to the expected growth rate in dividends, one cannot look only to an applicant utility's historical dividend policy as an indicator of investor expectations as to a realistic, sustainable dividend growth rate. A firm's earnings history must also be considered, for company decisions to increase dividends without adequate earnings support represent borrowings against future earnings, a fact which the evidence suggests investors readily recognize (S.R., p. 23; Staff Ex. 1, p. 16; *See also Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]). Finally, the growth estimate must recognize the relationship between yield and growth implicit in investor decisions.

Although Mr. Maugans points to a number of factors he believes the Commission should consider in selecting a growth estimate for purposes of determining the cost of equity (App. Ex. 4A, pp. 17-19), he apparently arrived at his 5.4 percent estimate by simply averaging the percentage increase in total dividends to be paid in 1982 over those paid in 1981, or 5.3 percent, with the 5.5 increase that would occur from 1982 to 1983 if the company raised its dividend by the same amount in the fourth quarter of 1983 as it did in the fourth quarter of 1982 (App. Ex. 4A, p. 21). As indicated above, the Commission does not consider a company's actual dividend growth, of itself, to be

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

the definitive measure for the "g" value in the DCF model, but even if we were to ascribe such importance to actual dividend growth, we could not agree that the use of Mr. Maugans' 5.4 percent estimate is reasonable under the circumstances presented here. Applicant has, for a period of some years, increased its dividend by two cents in the first quarter of each year (Tr. VIII, pp. 45-46). However, in 1982, in addition to the two cent increase authorized in the first quarter, the company also raised its dividend by an additional three cents per share in the fourth quarter (App. Ex. 4A, p. 21). Although the three cent increase does produce a 5.3 percent increase in dividends paid in 1982 over those paid in 1981, this one-year phenomenon is not a representative basis upon which to base an estimate of future dividend growth. Indeed, by Mr. Maugans' own admission, the additional three cent increase in 1982 was designed to prevent the growth rate from slipping below four percent, the nominal growth rate the company had maintained for many years (Tr. VIII, p. 47). Further, this departure from the company's long-standing practice of increasing its dividend only in the first quarter may, in large measure, have been precipitated by the fact that the company was undertaking a common stock sale in October of 1982, shortly after the fourth quarter dividend was announced (Tr. VIII, p. 48). This is not to say that accelerating the increase from the first quarter of 1983 to the fourth quarter of 1982 was not a reasonable decision in light of the forthcoming common stock offering, but merely to indicate that the resulting one-year growth rate is not particularly valid evidence of what investors may reasonably expect the long-term, sustainable growth rate in dividends to be. Finally, to estimate a growth rate for 1983 based on the assumption of another three cent increase in the fourth quarter of 1983 rather begs the question.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Mr. Jeffries did not base his dividend growth estimate of 4.0 to 4.5 percent on any specific calculation, but considered a number of factors in reaching his recommendation. Mr. Jeffries examined applicant's historical growth rates for book value, earnings, and dividends for the period 1971 to 1981, finding them to be 3.7 percent, 1.9 percent, and 3.6 percent, respectively (App. Ex. 8, p. 20). Based on a one-year " $b \times r$ " analysis in which he used an assumed retention rate (" $b$ ") and the return on equity (" $r$ ") authorized in the company's last case, and on various *Value Line* estimates, Mr. Jeffries concluded that future growth rates would generally be higher than the company's historical growth rates (App. Ex. 8, p. 20). The Commission does not believe the cursory discussion offered by Mr. Jeffries to be sufficient to support the use of the growth value he recommends. Earnings growth is deserving of far more attention than either of applicant's witnesses have devoted to it. The ten-year figures supplied by Mr. Jeffries clearly show that this company's dividend growth has exceeded its earnings growth by some margin. The five-year figures presented by Mr. Farrar yield the same conclusion. The compound earnings growth for the period 1976 to 1981 has been 1.15 percent, while dividends have grown at a compound rate of 4.0 percent (S.R., p. 20; Staff Ex. 1, p. 5). As applicant points out, dividend growth can exceed earnings growth over a period of several years (App. Ex. 4A, pp. 19-20), but this cannot continue indefinitely. This company has had negative cash retained earnings per share for the last ten years and has relied on AFUDC earnings to support its dividend policy (S.R., pp. 20-21). Although we would agree that the company's earnings picture has brightened in recent months, we do not believe that all this history can be ignored in developing a realistic growth estimate for this company.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Staff witness Farrar based his 2.0 percent growth estimate on the results of a "b x r" analysis, as well as on a review of the company's historical earnings and dividend growth. As in the company's prior two cases, applicant has criticized the use of a "b x r" calculation, when "b" equals the retention rate of earnings, and "r", the return on the equity funds retained, as a basis for the dividend growth estimate, but the Commission continues to believe that this method yields a reasonable indication of anticipated growth. Applicant's average "b x r" for the past five years is 2.79 percent (Staff Ex. 1, p. 5). However, as Mr. Farrar has explained in each of applicant's last three rate cases, the strict use of the five-year "b x r" fails to adequately reflect the precipitous drop in "b x r" between 1977 and 1978 (See, e.g., *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]). Each of the years from 1979 to 1981 has exhibited a "b x r" below any single "b x r" value of the previous eight years (Staff Ex. 1, p. 24). The average "b x r" for the five-year period is 1.96 percent (Staff Ex. 1, p. 5). This result, combined with the low earnings growth rates discussed above, leads the Commission to conclude that Mr. Farrar's use of a 2.0 percent growth value in the DCF formula is not unreasonable. However, we do not believe that Mr. Farrar's growth recommendation can properly be accepted without some adjustment.

Although the Commission recognizes that Mr. Farrar's 2.0 percent "g" value is not solely the product of his "b x r" calculation, we note that Mr. Farrar did not consider any 1982 results in his "b x r" analysis. Had he done so, it is apparent that the "b x r" value would have been higher, and would, we believe, support a higher growth estimate. Mr. Farrar did not object to the use of current growth data (Tr. IX, pp. 28-29), and we believe that if the relationship between yield and growth is to be properly recognized

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

in the DCF calculation, the data should, to the extent possible, be taken from the same time frame (*See Dayton Power and Light Company*, Case No. 81-21-EL-AIR [February 3, 1982]). Simply stated, consideration of recent growth data is consistent with the use of current data in the yield calculation. The "b x r" for the twelve months ended September 30, 1982 is 4.88 percent (App. Ex. 4B). Combining this "b x r" value with the "b x r" values from the five preceding calendar years results in a five-year average "b x r" of 2.54 percent. The Commission believes that 2.54 percent represents the appropriate growth estimate for use in the DCF equation in this case. Adding Mr. Farrar's yield component of 13.72 percent to a growth component of 2.54 percent produces an indicated base line cost of equity of 16.26 percent under the DCF approach.

In previous appearances before the Commission, both Mr. Maugans and Mr. Jeffries have offered various analyses in addition to DCF studies in support of their equity cost recommendations. In this case, however, only Mr. Jeffries offered a second equity cost analysis, a comparable earnings study very similar to those he has presented in prior testimony (App. Ex. 8, pp. 15-18). We see no purpose to be served by further discussion of Mr. Jeffries' comparable earnings methodology, as our previous comments with respect to his earlier presentations remain applicable here (*See, e.g., Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]). In short, there is nothing in Mr. Jeffries comparable earnings analysis which would persuade us that the DCF derived cost of equity as determined herein is not a reasonable measure of the cost of equity to this company.

The next question to be considered in determining the cost to be assigned the equity component of the capital structure is the adjustment to the DCF-derived base line cost of equity required to recognize issuance costs, dilu-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

tion, and the need for financing flexibility. Mr. Farrar, consistent with the staff's customary practice, applied adjustment factors of 1.032 and 1.10 to establish a range above the base line cost of equity within which the requirements associated with these items may reasonably be anticipated to fall (Staff Ex. 1, pp. 6-8). Although applicant's witness Jeffries recommended the 1.10 factor as the appropriate adjustment value, the company did not object to Mr. Farrar's methodology (App. Ex. 8, p. 21). Consumers' Counsel, through its filed objections, raised its usual challenge to the use of the 1.032 and 1.10 factors, including the argument that any adjustment for issuance costs or market pressure should be limited to only new equity issues. Intervenor's did not, however, pursue these objections at hearing or on brief. The Commission has addressed these arguments in considerable detail on a number of prior occasions and we see no reason to recount the analysis here (See, e.g., *Dayton Power and Light Company*, Case No. 80-687-EL-AIR [July 15, 1981]; *Cincinnati Gas and Electric Company*, Case No. 80-260-EL-AIR [March 18, 1981]; and, *Toledo Edison Company*, Case No. 81-620-EL-AIR [June 9, 1982]). An adjustment to the DCF-derived base line cost of equity is clearly appropriate, and the use of the staff's adjustment factors produces a reasonable result (*Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St.2d 303 [1981]). These objections should be overruled.

Applying the adjustment factors of 1.032 and 1.10 percent to the base line cost of equity of 16.26 percent as determined herein results in a range of 16.78 to 17.89 percent. The Commission finds the cost of equity capital to the company to be within this range.

Although the Commission has generally adopted the midpoint of the recommended range as the authorized equity return, in applicant's last rate case we found fac-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

tors present which we believed compelled the conclusion that the authorized return should fall in the lower half of the range (*Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]). The first of those, the acceptance of a future test year, was seen as supporting the use of the lower bound of the range. The second, the increased risk resulting from the Supreme Court's decision with respect to applicant's terminated nuclear units in *Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St.2d 153 (1981), was viewed as justifying an adjustment upward to the first quartile. Based on the circumstances presented by the instant case, we believe a return to the midpoint of the range to be appropriate. First, the Commission has used the traditional test year for purposes of its accounting analysis. To further limit the earnings opportunity by the use of an equity cost from the lower portion of the range would be unduly restrictive. Second, although we believe that the impact of the *Consumers' Counsel* decision, *supra*, must be recognized in the rate of return authorized, we agree with applicant's witness Maugans that the DCF method used in determining the base line cost of equity in this case, given the time that has now elapsed, does specifically account for the additional investor risk resulting from the Court's July 15, 1981 decision (App. Ex. 4A, p. 22). The use of the midpoint of the recommended equity cost range, or 17.33 percent, results in a rate of return which reflects this increased risk. Thus, the Commission finds 17.33 percent to be a reasonable estimate of the cost of equity capital to this utility. The cancellation costs, although not includable as allowable expenses for ratemaking purposes, may continue to be amortized for book accounting purposes in accordance with the Commission's decision in the company's last rate case (*Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]).

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

The City of Cleveland filed a series of objections through which it contends that the staff failed to consider a number of specific factors which, as we interpret the argument, intervenor believes should be viewed as grounds for reducing the authorized rate of return below the level indicated by the cost of capital analysis. These objections are without merit, as all the cited factors have, to the extent appropriate, been explicitly dealt with in the cost of service analysis or implicitly recognized in the rate of return analysis through the use of a market-based approach to the cost of capital determination. If the suggestion is that the cited factors should influence the Commission's choice of a point within the equity cost range otherwise deemed reasonable, we would, from a theoretical standpoint, be more receptive. However, as applicant points out, there are also circumstances faced by the company which would decidedly cut the other way (App. Br., pp. 72-74, 83-84). Thus, we believe the use of the midpoint of the range strikes a reasonable balance between these competing considerations, and find the cost of equity for purposes of this proceeding to be 17.33 percent.

The remaining issue relating generally to the cost of equity determination flows from a filed objection which has not been actively pursued by its sponsor. Applicant objected to the staff's failure to recommend an explicit attrition adjustment (S.R., p. 19), as well as to the staff's failure to comment on or recommend any implicit allowance for attrition in its cost of equity analysis. Although we recognize that applicant has attempted to address the attrition question through the use of a future test year, we note that neither of the rate of return witnesses proposed any specific attrition adjustment in this case. The Commission has, on a number of occasions, explained its view that, in the absence of special circumstances, no attrition adjustment is required in connection with a DCF-derived cost of

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

equity analysis (See, e.g., *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]; see also *Franklin County Welfare Rights Organization v. Public Utilities Commission*, 55 Ohio St.2d 1 [1978]; *Masury Water Company*, 58 Ohio St.2d 1 [1979]). Applicant's objection should be overruled.

**Rate of Return Summary:**

A cost of equity of 17.33 percent applied to the equity component of the capital structure approved herein, when combined with the findings relative to long-term debt and preferred stock, produces a weighted cost of capital of 12.60 percent as illustrated by the following table.

	<u>Amount</u>	<u>% of Total</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-term Debt	\$1,415,056,305	47.02%	9.60%	4.51%
Preferred/Preference Stock	415,898,533	13.82%	9.43%	1.30%
Common Stock	1,178,538,503	39.16%	17.33%	6.79%
	<u>\$3,009,493,341</u>	<u>100.00%</u>		<u>12.60%</u>

The Commission is of the opinion that a rate of return of 12.60 percent is sufficient to provide the company reasonable compensation and return for the electric service rendered customers affected by this application.

**AUTHORIZED INCREASE**

A rate of return of 12.60 percent applied to the jurisdictional rate base of \$2,198,419,000 approved for purposes of this proceeding results in an allowable return of \$277,001,000. Certain expenses must be adjusted if the gross revenues authorized are to produce this dollar return. These adjustments, which have been calculated in a manner consistent with the findings herein, result in an increase in federal income tax of \$39,217,000, in Pennsyl-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

vania Corporate Net Income Tax of \$401,000, in state excise tax of \$3,525,000, and in the allowance for uncollectibles of \$239,000. Adding the approved dollar return to the adjusted allowable expenses results in a finding that applicant is entitled to place rates in effect which will generate \$1,291,325,000 in gross annual operating revenue. This represents an increase of \$89,419,000 over the revenues which would be realized under applicant's present rate schedules.

**TARIFFS**

As a part of its investigation in this matter, the staff reviewed the various rate schedules and the provisions governing terms and conditions of service set out in applicant's proposed tariffs (S.R., pp. 44-71; Staff Ex. 5; Staff Ex. 6). Although there were a number of objections to the resulting staff recommendations, many of the questions raised have been resolved to the satisfaction of the affected parties and the staff through joint stipulations and recommendations offered at hearing (Tr. XV, pp. 197-198). The proposed disposition of these issues and the remaining tariff-related objections are discussed below.

Subsequent to the filing of the instant application, the Commission approved a company request to replace its existing tariff, PUCO No. 11, with a new tariff, PUCO No. 12 *Cleveland Electric Illuminating Company*, Case No. 82-976-EL-ATA [August 25, 1982]). No substantive changes were involved, the purpose being merely to revise the existing format, to renumber certain schedules, and to eliminate obsolete provisions. Thus, all references to the present and proposed tariffs in this discussion refer to PUCO No. 12 (App. Ex. 2D, Sched. E-1, E-2, and E-2A).

**Revenue Responsibility:**

The staff's recommended allocation of the increase in revenue requirements to the various rate schedules drew

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

objection from the applicant, Consumers' Counsel, the City of Cleveland, Senior Citizens, *et al.*, and the Industrial Electricity Consumers (S.R., pp. 44-48). However, the revenue distribution controversy has been resolved by a stipulation offered at hearing through which the above parties propose, and the staff recommends, a specific allocation of the authorized revenue increase to the affected rate classifications (Jt. Ex. 1). The Commission is, of course, not bound by this joint stipulation and recommendation, but should certainly not ignore the unanimous agreement of parties representing such a broad range of interests, particularly in light of the nature of the subject involved. Further, the distribution of the increase proposed in the stipulation is reasonable and is supported by the record. Accordingly, the Commission finds that the increase in revenues authorized herein should be allocated to the various rate schedules so as to conform, as nearly as possible, with the distribution proposed in the joint stipulation and recommendation (Jt. Ex. 1, Para. 1). Although the Commission will accept the revised billing determinants proposed by applicant's witness Bingham for purposes of calculating the specific rate levels required to produce the authorized increase (App. Ex. 7A, pp. 5-6; App. Ex. 7B), this should not be construed as justifying a departure from the overall revenue distribution agreed to by the parties and recommended by the staff.

**Residential Rate Schedules:**

Applicant's present and proposed tariffs contain three rate schedules applicable to residential service: the Residential Schedule (App. Ex. 2D, Sched. E-2, pp. 1-2; App. Ex. 21; Sched. E-1, pp. 1-2), the Residential Energy Conservation Schedule (App. Ex. 2D, Sched. E-2, p. 3; App. Ex. 2D, Sched. E-1, p. 3), and the Experimental Residential

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Time-of-Day Schedule (App. Ex. 2D, Sched. E-2, pp. 4-5; App. Ex. 2D, Sched. E-1, pp. 4-5). Issues have been raised in connection with all three schedules.

*Residential Customer Charge:*

Applicant's current Residential Schedule and Residential Energy Conservation Schedule contain a \$1.50 monthly customer charge. The staff, using its standard method for calculating customer costs, recommended that the customer charge be increased to \$2.50 per month (S.R., pp. 51, 63). The applicant, Consumers' Counsel, City of Cleveland, Senior Citizens, *et al.*, and the Fair Rates Campaign Coalition all objected to this staff recommendation, contending that the customer charge provision should be eliminated or, if retained, should remain at its current level. At hearing, the company, Consumers' Counsel, and the staff jointly offered a stipulation by which they agree and recommend that in lieu of a fixed customer charge in these schedules, the existing initial energy block be split, with the first 500 kwh priced at 0.5¢ per kwh more than the second 500 kwh (Jt. Ex. 2, Para. 1). The City of Cleveland and the Fair Rates Campaign Coalition, although not joining in the stipulation, have indicated that they do not oppose this resolution of the matter (Tr. XV, p. 176). However intervenor Senior Citizens, *et al.*, continues to object.

This Commission has, for many years, recognized the customer charge as an appropriate mechanism by which to reflect and recover those costs which do not vary with usage (*See Cleveland v. Public Utilities Commission*, 63 Ohio St.2d 62 [1980]). Indeed, every major gas and electric utility subject to Commission jurisdiction has this type of monthly charge in its residential rate schedules. Moreover, as the Commission has pointed out on a number of prior occasions, the staff method for determining the customer costs to be reflected in the customer charge produces

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

a conservative result, as there are clearly many non-usage sensitive costs which are not captured through the staff's calculation (*See, e.g., Toledo Edison Company*, Case No. 80-377-EL-AIR [April 9, 1981]). The customer charge has, however, been the source of considerable controversy in Commission rate proceedings, not because of any question as to its theoretical validity, but because it has been so poorly understood by some customers. This was one of the factors which prompted the Commission to approve a reduction in applicant's existing customer charge in the company's last rate case and to indicate that it would consider eliminating the charge in a future proceeding (*Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR [March 17, 1982]). Given the fact that we now have a specific proposal to replace the customer charge with a rate mechanism which will continue to recognize the principle that customer costs should be recovered in the first step of the rate (Tr. XI, p. 26), and given the fact that this proposal is endorsed by both the applicant and Consumers' Counsel, the parties with the most direct interest in the matter, the Commission is of the opinion that the stipulation should be accepted. In so finding, we do not intend to suggest in any way that we do not still consider the customer charge to be an appropriate rate element; we agree with staff witness Groves' observation that the stipulated resolution represents nothing more than a reasonable compromise which is acceptable because of the unique circumstances presented by this case (Staff Ex. 6, p. 11).

As indicated above, intervenor Senior Citizens, *et al.*, opposes the residential rate design now proposed by the applicant, Consumers' Counsel, and the staff, contending that the customer charge, to which it initially objected has merely been hidden in the beginning energy charges. Although we take exception to the characterization of the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

charges as being hidden, we agree that the customer-related costs are recognized in the initial step of the proposed rate. The fact that there is no customer charge in the rate schedule does not mean that these customer-related costs somehow disappear. They remain part of the residential revenue requirement no matter what rate structure is approved. If that rate structure is to track cost incurrence, non-usage sensitive costs must be recovered in the initial part of the rate whether through a specific customer charge or through the first rate block (Staff Ex. 6, p. 11; Tr. XI, p. 26). What intervenor wants, of course, is not a cost-based rate, but a rate design under which the high-use residential customer subsidizes the low-use customer. This desire stems from intervenor's notion that low income customers are all low users of electricity, a proposition we have never accepted as being universally true, and one for which there is certainly no concrete support in this record. This Commission understands all too well the hardships utility rate increases may work on some segments of our society. However, even if the Commission had the authority to base rates on ability to pay, which we obviously do not, we would think relative electricity usage to be an extraordinarily inappropriate basis upon which to predicate an intraclass subsidy designed to benefit low income residential customers. The objection of intervenor Senior Citizens, *et al.*, to the stipulation should be overruled.

***Space Heating/Water Heating Discounts:***

Applicant's standard Residential Schedule provides reduced rates for usage by space heating and water heating customers above certain specified kwh levels. This discount provision is available only to customers whose appliances were installed prior to the closing of the rate in *Cleveland Electric Illuminating Company*, Case No. 71-634-Y [November 28, 1973], Order on Remand [July 3, 1975]). Some

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

50,000 customers are still served under this provision (S.R., p. 51). Intervenor Senior Citizens, *et al.*, objected to the staff's failure to recommend the elimination of these discounts, but did not pursue its objection at hearing or on brief. The Commission continues to believe it appropriate to permit this rate to be gradually eliminated through attrition and overrules the objection (*See* Staff Ex. 6, p. 10; *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR [July 10, 1980]; and *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR [May 1, 1981]).

***Residential Energy Conservation Schedule:***

Applicant's Residential Energy Conservation Schedule is available on an optional basis to customers whose premises meet or exceed certain specified insulation and conservation standards. In *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982), the Commission accepted a residential conservation schedule in which the previously existing differential between the rate for the initial block of the summer rate in the conservation schedule and the rate for the comparable block in the standard schedule had been eliminated. In this proceeding, applicant's witness Bingham has proposed that this differential be restored (App. Ex. 7A, pp. 7-8), a measure also supported by the staff (Staff Ex. 6, pp. 7-8), and Consumers' Counsel (Jt. Ex. 2, Para. 3). The Commission finds this proposal to be reasonable. Each of the 500 kwh blocks created pursuant to the stipulation eliminating the customer charge shall be priced 0.5¢ below the corresponding blocks in the Residential Schedule.

***Experimental Residential Time-of-Day Schedule:***

Applicant is presently engaged in a residential time-of-day experiment which involves a limited number of res-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

idential customers. The company submitted an interim report on the progress of the experiment in July of 1981. The staff, in its report of investigation in this case, criticized certain features of the study and recommended that an additional report be filed detailing the conclusions reached to date with respect to certain identified aspects of the experiment and presenting certain additional demand data (S.R., p. 52). The staff further recommended that the study be broadened in scope (S.R., p. 52). Applicant's witness Bingham agreed that the recommended report should be submitted, but suggested that any determination with respect to the future of the experiment be delayed until after a review of the report (App. Ex. 7A, p. 7). Staff witness Groves agreed with this proposal (Staff Ex. 5, p. 7), and the Commission believes it only prudent to assess the available results before considering a new direction for the experiment. Mr. Bingham has indicated that the report could be submitted in advance of the date originally specified by the staff. The Commission, therefore, directs that said report be submitted on or before March 1, 1983, with copies to be made available, upon request, to parties of record in this proceeding.

In its report, the staff also recommended that a rate be established which would extend the time-of-day rate principle to customers who controlled demand through automatic timers and heat storage units (S.R., pp. 53-54). The City of Cleveland, apparently interpreting this recommendation to mean that only electric heating customers would benefit, objected, contending that all customers who controlled demand through any automatic device should be permitted to avail themselves of such a rate. However, as staff witness Hefner explained at hearing, it was not the staff's intention to limit its proposal to any particular class or sub-class of customers, but merely to raise the point that technological developments which may facilitate de-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

mand control should not be ignored in developing time-differentiated rates (Staff Ex. 5, pp. 6-7; Tr. XIV, pp. 4-20). Mr. Hefner further explained that it was not the staff's intention that any particular rate of this type be implemented as a result of this case, but merely that the matter be given consideration in the future (Tr. XIV, p. 5). To this end, we believe it appropriate to require applicant to respond to the staff's recommendation as a part of the report described above and will so direct.

***Intraclass Revenue Distribution:***

As a part of the stipulation and recommendation dealing with residential rates, the applicant, Consumers' Counsel, and the staff have proposed that the distribution of the revenue increase between the Residential Schedule, the Residential Energy Conservation Schedule, and the Experimental Residential Time-of-Day Schedule be in essentially the same proportion as initially proposed by the company (Jt. Ex. 2, Para. 2). No party has objected to this aspect of the stipulation, and the Commission finds that it should be accepted. The residential schedules filed pursuant to this Order shall reflect this proposed intraclass revenue distribution.

**Industrial Rate Schedules:**

Because the rates noticed by applicant in connection with this proceeding were developed prior to the Commission's Order in *Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR (March 17, 1982), the proposed Industrial Schedule (App. Ex. 2, Sched. E-1, p. 8) and Large Industrial Schedule (App. Ex. 2, Sched. E-1, pp. 9-10) did not reflect certain changes in rate design approved by the Commission in that case. The applicant and the staff agreed that the design of these schedules should

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

be consistent with the design adopted in the prior case, but did not offer specific recommendations as to the appropriate levels for each of the rate components (App. Ex. 7, pp. 8-9; S.R., p. 58). Intervenor Industrial Electricity Consumers objected to the staff's failure to make such recommendations, and submitted proposed designs for the two schedules (IEC Ex. 2, pp. 14-22; IEC Ex. 2, Sched. 11-15). However, at hearing, the company, the staff, and the Industrial Electricity Consumers jointly offered a stipulation and recommendation detailing an agreed to resolution of all issues associated with the design of the Industrial Schedule and Large Industrial Schedule, including the manner in which the increase authorized is to be spread to the various rate components (Jt. Ex. 4). The Commission is of the opinion that this stipulation and recommendation is fully supported by the record and is, in all respects, reasonable and proper. Thus, the Commission finds that the Industrial Schedule and Large Industrial Schedule filed pursuant to this Order shall be designed in accordance with the stipulation and recommendation.

**Demand Verification:**

The City of Cleveland objected to the staff's failure to recommend that applicant be required to provide same means by which all industrial customers can verify their demand on an ongoing basis without incurring additional costs. Although the record is far from clear on this subject, we take it that intervenor's complaint is that those industrial customers whose service is metered by an indicating demand meter may, if they desire, visually monitor their demand at half-hour intervals, while those customers with magnetic tape recording demand meters must install additional equipment to acquire this same capability. Citing testimony of staff witness Groves indicating that he be-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

lieved it appropriate that all industrial customers be able to monitor their demand (Tr. XIV, pp. 35-36), intervenor contends that it is unreasonable that some customers must incur additional costs to do so.

There are several observations to be made in connection with the City of Cleveland objection. First, based upon this record, it is rather difficult to determine how significant this alleged problem is, if, indeed, one exists at all. Contrary to intervenor's assertion on brief, applicant has not suddenly embarked on the process of systematically changing out indicating demand meters and replacing them with magnetic tape recording demand meters (City of Cleveland Br., p. 45). The magnetic tape meters, which provide for a more accurate resolution of billing demand than do the indicating demand meters, have been used in connection with service to some large customers since the late 1960's (Tr. VIII, p. 140). Although the company is contemplating going to a more advanced type of metering in the future (Tr. VIII, p. 141), there are no present plans to remove the indicating demand meters currently in place for the vast majority of the company's industrial customers (Tr. VIII, p. 141-142). Although there are several hundred of the magnetic tape meters on the system (Tr. VIII, p. 141), many of which have been in place for a number of years, we have never previously been called upon to consider a complaint or objection of this type. Thus, we are somewhat curious as to what particular circumstance has prompted this intervenor to raise the question at this time. Although we assume that the City has some installation where service is metered with a magnetic tape meter, there is no evidence of this in the record, nor has there been a showing that intervenor could benefit even if it had the same ability to visually monitor its demand that it would have with an indicating demand

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

meter. Indeed, there is some suggestion that a similar capability does exist (Tr. VIII, p. 144; Tr. XIV, pp. 34, 39).

The most significant point for purposes at hand is, however, that City of Cleveland has yet to explain precisely what it would have the Commission do to remedy this alleged problem. If it is intervenor's contention that applicant should be required to remove the offending magnetic tape recording demand meter and replace it with an indicating demand meter, then this matter should have been raised by way of a complaint proceeding. It would clearly have nothing to do with a general rate case and can not even be considered in the context of this proceeding as the requirement of Section 4909.153 Revised Code has not been met. On the other hand, if what intervenor wants is for the company to provide, at no charge to the City, the additional equipment necessary to permit it to verify its demand at some particular location, it has failed to explain who it believes should bear this expense. On its face, it would appear only appropriate that the customer who receives the benefit ought to pay the associated costs, but, in any event, this record is not sufficiently developed to permit any alternative allocation. This objection should be overruled.

**Pole Attachment Tariff:**

By entry of March 31, 1982 in Case No. 81-1109-AU-ORD, the Commission ordered all telephone, telegraph, and electric light companies subject to its jurisdiction to submit tariffs setting out charges terms, and conditions for attachments to company-owned poles. This directive was issued pursuant to Sections 4905.71 and 4905.72 Revised Code, which now vest the Commission with authority to regulate such pole attachments. The Cleveland Electric Illuminating Company, in compliance with this Entry, submitted a pole attachment tariff for the Commission's

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

review. As a part of its report of investigation in the instant rate case, the staff recommended that the reasonableness of the pole attachment tariff be considered in the context of this proceeding, and proposed certain minimum and maximum annual rates for pole attachments (S.R., p. 61-62). The applicant, the Ohio Cable Television Association, and the City of Cleveland all filed objections relating to the staff's pole attachment recommendations.

At hearing, the applicant, the Ohio Cable Television Association, and the staff jointly offered a stipulation by which the parties agree and the staff recommends that the attachment fee for pole attachments by cable television and private communication systems be established as \$3.45 per pole attachment per year, with all other provisions of the tariff to be in the form originally proposed by the company (Jt. Ex. 3, Para. 2; Jt. Ex. 3, Ex. A). The parties have further agreed that applicant will cancel its existing pole attachment contracts effective as of the effective date of the pole attachment tariff (Jt. Ex. 3, Para. 1). Although this stipulation resolves all pole attachment issues between the applicant, the Ohio Cable Television Association and the staff, it apparently does not satisfy the City of Cleveland's objection in this area.

The proposed pole attachment tariff contains two parts. Part A deals expressly with pole attachments by cable television and private communications systems. Pursuant to the stipulation, the rate for such attachments would be \$3.45 per pole attachment per year. The language setting out the terms and conditions for such attachments is identical to the language contained in applicant's existing contracts with cable television companies operating in its service territory. Although the City of Cleveland has objected generally to consideration of the pole attachment question in this case, intervenor does not take issue with the rate proposed in the stipulation or with Part A of the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

proposed tariff (Tr. XV, pp. 180-181). Indeed, because the stipulated rate and Part A of the tariff apply only to cable television and private communications systems, the City would appear to have no standing to object even if it did oppose the \$3.45 rate or the Part A provisions.

Part B of the proposed tariff sets out terms and conditions for pole attachments by any person or entity other than a public or municipal utility or those entities covered by Part A. There are no specific rates for pole attachments contained in Part B, although the tariff does provide that the company may impose a charge to recover any costs it incurs in connection with measures required to accommodate attachments. The City of Cleveland's filed objection relating to Part B of the proposed tariff charges that the Commission is without jurisdiction "to set rates or terms and conditions of service for municipal attachments such as traffic signals or lighting which matters have been constitutionally assigned to municipalities." The objection further states that "[w]ithout waiving the jurisdictional question, the rates for these charges as specified in original sheets 36 & 37 are inordinately vague and open-ended."

We preface our discussion of this objection, and the controversy it has generated, with the observation that the Commission is not empowered to decide constitutional questions. Thus, any arguments as to the constitutionality of the proposed tariff, or, for that matter, Section 4905.71 Revised Code, itself, must be left to other forums. We would note, however, that the City of Cleveland's pursuit of this objection has taken a most peculiar turn. Intervenor begins with the proposition that the Commission has no jurisdiction to approve a tariff which is, in any way, in derogation of a municipality's home rule powers, but ends by urging the Commission to construe the statute so as to approve a tariff which would impinge upon powers

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

specifically conferred to a municipality by Article XVII of the Ohio Constitution.

Given the language of the filed objection, one might have reasonably concluded that intervenor's real concern was that the company would invoke Part B of the proposed pole attachment tariff to either prevent the City from placing items such as fire alarm boxes, police emergency call boxes, and traffic signal devices on its poles, or to impose a charge for such attachments. Applicant, pointing out that the company has, throughout its history, permitted such attachments without charge, represent that it has no intention or desire to alter this practice. In an effort to eliminate all confusion in this regard, applicant suggested that its proposed tariff be amended to specifically exclude the attachments of these facilities from its ambit (Tr. XV, p. 145). Unfortunately, the proffered solution will not cure the problem, as Section 4905.71 Revised Code requires that the company file tariffs governing such attachments.

The City contends that the pole attachment tariff must specifically confirm the municipality's constitutional authority to make these attachments, and must further provide that the company will not impose any charge for attachments made by a municipality for safety and/or traffic control purposes. We fail to see why the first of these conditions is necessary, and believe that the proposed tariff, as drafted, already satisfies the second. The question of whether or not the right of the municipality to make these attachments flows from the home rule provision of the Ohio Constitution would appear to be irrelevant, for the tariff clearly permits the municipality to make the attachments. Indeed, if there is such a constitutional right, what the tariff might say on the subject would obviously be superfluous. With respect to the second issue, we see no need for specific language indicating that the company will not impose a charge for these attachments. The com-

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

pany can only charge in accordance with the tariff, and, as indicated above, Part B of the proposed tariff contains no pole attachment rate. It is true that Part B of the tariff would permit the company to recover any special costs incurred to accommodate the attachments, but this is certainly not the same thing as an annual rate which must be paid as a condition of maintaining the attachment. Further, the Commission cannot agree with the City's complaint that the provisions governing the company's recovery of costs incurred in connection with accommodating the attachments are "inordinately vague and open-ended." Part B, Section VIII of the proposed tariff describes in detail the costs that may be recovered. By their very nature, such costs will differ from location to location, but this does not render the tariff provisions "inordinately vague and open-ended." Moreover, although the Commission has no authority to decide constitutional questions, we do not think it overstepping to note that even if a municipality's right to make these attachments flows from Article XVIII of the Ohio Constitution a municipality, in the absence of some specific agreement, would still be required to reimburse the utility for any costs it incurred to make the attachment.

Although the foregoing discussion is dispositive of the issues raised through the filed objection, the City of Cleveland's attempt to enlarge the pole attachment question beyond these bounds also requires response. Given the fact that there was no evidence that there has ever been a problem between applicant and the City concerning the attachment of fire alarm boxes and the like, and given applicant's representation that it is not its intention to alter that relationship through the filing of this tariff, it was somewhat difficult to understand why intervenor attached such importance to this matter. However, all becomes clear when we review the amendments to the tariff proposed by the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

City and the arguments it advances on brief. What the City of Cleveland really wants is to use this tariff as authority to attach the wires of its own electric utility to Cleveland Electric Illuminating Company poles.

Section 4905.71 Revised Code requires that applicant permit, subject to reasonable terms, conditions, and charges, pole attachments by “. . . any person or entity other than a public utility . . .” and that applicant file tariffs containing these terms, conditions, and charges. Intervenor contends that because neither Part A or Part B of applicant’s proposed tariff is applicable to attachments by municipal utilities, the proposed tariff does not comply with the statute. The Commission cannot agree that Section 4905.71 Revised Code requires applicant to establish a tariff offering which would allow its competitor, Cleveland’s municipal electric system, to attach its power lines to applicant’s poles. As applicant argues on brief, the statute clearly designates persons or entities “other than a public utility” as the parties which are to be permitted to make attachments. As Section 4905.02 Revised Code indicates, there is a distinction between “a public utility as defined by Section 4905.02 Revised Code” and “such other public utilities as are owned and operated by any municipal corporation.” Section 4905.71 Revised Code recognizes that distinction by identifying “a public utility as defined by Section 4905.02 Revised Code” as the entity that must permit attachments and person or entities “other than a public utility”, without any specific definition, as the parties that may make the attachment.

If there is any ambiguity here, we think intervenor’s failure to suggest any rationale as to why the legislature would distinguish between regulated and non-regulated public utilities in defining the parties to be permitted to make attachments ought to resolve this matter. In fact, all the City of Cleveland’s arguments cut precisely in the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

opposite direction from the conclusion intervenor would have us reach. If, as the City claims, the Commission has no jurisdiction over municipal utility attachments because the right to make such attachments flows from Article XVIII, Section 4 of the Ohio Constitution, how can intervenor urge a construction which would subject the operation of the municipal utility to regulation of this type? (See *State ex rel. McCann v. Defiance*, 167 Ohio St. 313, at 316). More importantly, why would the General Assembly believe it necessary to specifically require regulated utilities to permit attachments by municipal utilities when municipalities clearly have all powers necessary to operate a public utility pursuant to Article XVIII, Section 4 of the Ohio Constitution? We simply cannot see a logical basis for assuming that the legislature meant to distinguish between regulated public utilities and non-regulated public utilities in defining those parties to be permitted to make attachments and believe that the term "public utility" in the phrase "other than a public utility" must be read to mean public utilities, generally.

Even if the Commission's interpretation of Section 4905.71 Revised Code should prove to be in error, the failure of the proposed tariff to provide for attachments by municipal electric utilities would not invalidate the provisions it does include. Further, even if we believed that Section 4905.71 Revised Code required applicant to offer a tariff governing pole attachments by municipal electric utilities, there is simply no evidence in this record which would permit us to develop appropriate provisions to govern what would obviously be a very complicated relationship due to, among other things, the safety considerations involved. Contrary to intervenor's assertion on brief, the reason there is no such evidence on this subject is not the presiding examiner's ruling that this was solely a legal question (Tr. XV, p. 194), but the fact that there was

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

no hint until the afternoon of the final day of hearing that what the City of Cleveland was really after was a pole attachment tariff which would permit its municipal electric system to attach its wires to applicant's poles (Tr. XV, p. 145). The question was certainly not raised through intervenor's filed objections, nor did the City even propose to offer a witness on the subject.

The remaining question in this area also relates to a matter not specifically raised through the filed objections. The City of Cleveland contends that Part B of the tariff should be rejected because it is inconsistent with Section 4905.17 Revised Code. The first such inconsistency cited, the exclusion of municipal utilities in the "Applicability and Scope" provision (Jt. Ex. 3, Ex. A, Part B, Section I.A.), has already been adequately discussed. The use of "non-public or non-municipal utility system" in the tariff is, as explained above, the equivalent of the term "other than a public utility" employed in the statute. The second alleged inconsistency is in the criteria for determining when attachments will be permitted. Section 4905.17 Revised Code requires the company to permit the attachment "so long as the attachment does not interfere, obstruct, or delay the service and operation . . . or create a hazard to safety." The tariff provides that attachments will not be permitted "where in the sole judgment of the Company the attachments will interfere with the Company's own service requirements, or will be prejudicial to the economy, safety or future needs of the Company's service or the use of its facilities by others with prior rights to such use" (Jt. Ex. 1, Ex. A, Part B, Section I.B.). Although the language of the tariff may be somewhat broader than that of the statute, we do not believe it can be fairly said that the two are inconsistent, particularly in light of the fact that the statute also allows the company to impose "reasonable terms and conditions" before permitting attachments.

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

Although there is nothing in the record which would lead the Commission to anticipate that the company would capriciously deny permission to make attachments of the type contemplated by the statute, we think an adequate safeguard in this respect to be to delete the phrase "in the sole judgment of the Company," thereby insuring that, upon complaint, a company decision to refuse to permit an attachment will be subject to review.

Consistent with the foregoing discussion, the Commission finds that the stipulation and recommendation offered by applicant, the Ohio Cable Television Association, and the staff should be adopted, and that applicant's proposed pole attachment tariff should be approved, subject to the substitution of the stipulated rate of \$3.45 per pole attachment per year in Part A and the deletion of the phrase "in the sole judgment of the Company" from the "Applicability and Scope" provisions of Part B. Conformed tariffs, to be designated P.U.C.O. No. 1, shall be submitted at the time the applicant files its other revised tariffs for review. The objections of the City of Cleveland are overruled.

**Effective Date:**

The Commission's general practice is to require that applicant utilities notify customers of any rate increase authorized prior to the effective date of the new tariffs, and to delay the effective date in order that this customer notification can be accomplished. However, in instances where the Commission has not acted upon a rate application within 275 days of the date of filing, and where the applicant utility has not invoked the provisions of Section 4909.42 Revised Code to attempt to place its proposed rates in effect subject to refund, the Commission establishes the effective date of the new tariffs as of the date they are approved by Entry so as not to penalize the

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

company for its forbearance. In the instant case, applicant has not attempted to place its proposed rates in effect although the 275-day period has expired. Thus, the Commission finds that the effective date of the tariffs filed pursuant to this Order shall be the date they are approved by Commission Entry. The customary notification requirement will, of course, be retained, said notice to be mailed to customers upon approval of its form by the Commission.

**FINDINGS OF FACT:**

From the evidence of record in this proceeding, the Commission now makes the following findings:

- 1) The value of all of applicant's property used and useful for the rendition of electric service to the customers affected by this application, determined in accordance with Sections 4909.05 and 4909.15, Revised Code as of the date certain of February 28, 1982, is not less than \$2,198,419,000.
- 2) For the twelve month period ending August 31, 1982, the test period in this proceeding, the revenues, expenses, and income available for fixed charges realized by applicant under its present rate schedules were \$1,201,906,000, \$970,942,000, and \$230,964,000, respectively.
- 3) This net annual compensation of \$230,964,000 represents a rate of return of 10.51 percent on the jurisdictional rate base of \$2,198,419,000.
- 4) A rate of return of 10.51 percent is insufficient to provide applicant reasonable compensation for the service rendered customers affected by the application.
- 5) A rate of return of 12.60 percent is fair and reasonable under the circumstances presented by this case and is sufficient to provide applicant just compensation and return on the value of its

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

property used and useful in furnishing electric service to its jurisdictional customers.

- 6) A rate of return of 12.60 percent applied to the rate base of \$2,198,419,000 will result in income available for fixed charges in the amount of \$277,001,000.
- 7) The allowable annual expenses of the company for purposes of this proceeding are \$1,014,324,000.
- 8) The allowable gross annual revenue to which the applicant is entitled for purposes of this proceeding is the sum of the amounts stated in Findings 6 and 7, or \$1,291,325,000.
- 9) Applicant's present tariffs should be withdrawn and cancelled and applicant should submit new tariffs consistent in all respects with the discussion and findings set forth above.

**CONCLUSIONS OF LAW:**

- 1) The application herein was filed pursuant to, and this Commission has jurisdiction thereof under the provisions of Sections 4909.17, 4909.18 and 4909.19 Revised Code; further, the applicant has complied with the requirements of those statutes.
- 2) A staff investigation was conducted and a report duly filed and mailed, and public hearings have been held herein, the written notice of which complied with the requirements of Section 4909.19 Revised Code.
- 3) The existing rates and charges as set forth in the tariffs governing electric service to customers affected by this application are insufficient to provide the applicant with adequate net annual compensation and return on its property used and useful in the rendition of electric service.
- 4) A rate of return of 12.60 percent is fair and reasonable under the circumstances of this case and is sufficient to provide the company just compensation and return on its property used and

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

useful in the rendition of electric service to its customers.

- 5) Applicant should be authorized to cancel and withdraw its present tariffs on file with this Commission and to file tariffs consistent in all respects with the discussion and findings set forth above.

**ORDER:**

It is, therefore,

ORDERED, That the application of The Cleveland Electric Illuminating Company for authority to increase its rates and charges for electric service be granted to the extent provided in this Opinion and Order. It is, further,

ORDERED, That the company be authorized to cancel and withdraw its present tariffs and to file new tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) complete copies of tariffs conforming to this Opinion and Order, the Commission will review and approve same by Entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date said tariffs are approved by Commission Entry. The rates contained in the new tariffs shall be applicable to all service rendered on or after the effective date. It is, further,

ORDERED, That the company shall immediately commence notification of its customers of the increase in rates authorized herein by insert or attachment to its billings, by special mailing, or by a combination of these methods. Applicant shall submit a proposed form of notice to the Commission when it files its tariffs for approval and the Commission will review same and, if proper, approve it by Entry. It is, further,

**Opinion and Order, PUCO Case No. 81-1378-EL-AIR**

ORDERED, That, pursuant to the recommendation of the staff (S.R., p. 33), applicant continue to report quarterly on the immediate past performance of its generating units. It is, further,

ORDERED, That applicant submit the report relating to its time-of-day rate experiment as described in the "Tariffs" portion of this Opinion and Order on or before March 1, 1983. It is, further,

ORDERED, That all objections and motions not specifically discussed in this Opinion and Order, or rendered moot thereby, be overruled and denied. It is, further,

ORDERED, That a copy of this Opinion and Order be served on all parties of record.

**THE PUBLIC UTILITIES  
COMMISSION OF OHIO**

/s/ JON F. KELLY

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(Chairman)

/s/ DENNIS PINES

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/s/ MICHAEL DELBANE

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(Commissioners)

Entered in the Journal

Jan. 5, 1983

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A True Copy

DAVID M. POLK

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David M. Polk  
Secretary

Rehearing Entry, PUCO Case No. 81-146-EL-AIR

Rehearing Entry of the  
Public Utilities Commission of Ohio  
(Filed May 12, 1982)

BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company for authority to increase its  
filed schedules fixing rates and  
charges for electric service.

Case No.  
81-146-EL-AIR

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company to Recover Increases in the  
Public Utility Excise Tax on Gross  
Receipts by alternative methods than  
that provided by Case No. 81-1408-  
AU-UNC.

Case No.  
81-1565-EL-UNC

REHEARING ENTRY

The Commission, coming now to consider the above-entitled matters, and, specifically, its Opinion and Order in these dockets of March 17, 1982, and the applications for rehearing filed by the applicant and other participating parties, hereby makes the following findings:

- (1) On March 17, 1982, the Commission issued its Opinion and Order in these dockets granting, in part, the application of The Cleveland Electric Illuminating Company (CEI, company or applicant) for authority to increase its rates and charges for electric service rendered jurisdictional customers.

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

- (2) Rehearing applications were timely filed, pursuant to the provisions of Section 4903.10 Revised Code, by The Cleveland Electric Illuminating Company, the City of Cleveland, and the Office of Consumers' Counsel.
- (3) Through its rehearing application, the Cleveland Electric Illuminating Company alleges that the Commission's March 17, 1982 Opinion and Order is unreasonable and unlawful in some ten particulars, although many of the areas clearly interrelate. By its first assignment of error CEI alleges that the Commission erred in failing to provide an allowance for the amortization of costs incurred with respect to four cancelled nuclear generating plants. In doing so, however, the company acknowledges that the Supreme Court of Ohio, in *Consumers' Counsel v. Pub. Util. Comm.*, 67 Ohio St.2d 153 (1981), held that such an expense is, as a matter of law, not includable as an operating expense for ratemaking purposes. The thrust of the applicant's argument is that this decision of the Supreme Court of Ohio renders the Ohio regulatory statutes unconstitutional. This Commission lacks authority to determine the constitutionality of Ohio Statutes. *Panhandle Eastern Pipeline Co. v. Pub. Util. Comm.*, 56 Ohio St. 2d 334 (1978). Clearly, therefore, we must deny rehearing on this issue.
- (4) Applicant's second, third and fourth assignments of error address the Commission's treatment of allowance for funds used during construction (AFUDC). The thrust of applicant's argument on the AFUDC issue is that the Commission's imputed interest methodology is inappropriate and unreasonable. Applicant submits that it is "unfair" of the Commission to assume that this methodology is reasonable without any discussion of that assumption.

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

This is not the first time that the imputed interest issue has been presented to the Commission. In numerous cases this issue has been discussed and the Commission has found the Staff's method to be reasonable. (*See, e.g., Ohio Edison Company*, Case No. 80-141-EL-AIR, Opinion and Order, February 11, 1980; *Dayton Power & Light Co.*, Case No. 78-92-EL-AIR, Opinion and Order, March 9, 1979; and *Cleveland Electric Illuminating Co.*, Case No. 78-677-EL-AIR, Opinion and Order, May 2, 1979.) In addition to the Commission's previous decisions in this area, Staff witness Hanna in this case discussed at length the justification for the Staff's position and the pitfalls of the applicant's proposals. (Staff Ex. 10) Based upon this analysis we again find that the Staff's imputed interest methodology is appropriate for ratemaking purposes. For this reason we must reject the applicant's contention that our treatment of the AFUDC issue is unfair.

As an additional point on the AFUDC issue, the company contends that it is being unduly penalized retroactively by this decision. We do not agree with this contention. The company has been allowed to over-accrue AFUDC in rate base over the past several years, a circumstance which we now find should not have been allowed. The situation can be analogized to allowing the company to have an asset in rate base for a period of years, which we later find should never have been placed in rate base. Requiring the company to remove from rate base that asset that does not belong there is not retroactive ratemaking. The company's assignments of error on the AFUDC issue are denied.

- (5) With respect to the company's comments concerning gross receipts tax recovery, we must

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

point out to the company that rates in this case were established upon a fully forecasted test year commencing January 1, 1982. The company submits that it should be guaranteed recovery of the gross receipts tax expense that occurred outside this operating period in a prior year. To grant such a request would clearly include a past loss in current rates. The gross receipts tax allowance included in the rate case is representative of what charges the company will incur during 1982.

- (6) Review of the remaining assignments of error indicates that the majority represent nothing more than a restatement of the company's original position relative to those issues which now have been decided adversely to the applicant. The Commission is of the opinion that these claims were adequately addressed in the order now complained of with the exception of two points.

First the company correctly points out that the Opinion and Order fails to authorize the applicant to normalize under the Economic Recovery Tax Act the tax benefits from the investment tax credit on its recovery property placed in service after December 31, 1980. It should be noted that this omission has no impact on the revenue levels established in this case. The company should be authorized, however, to normalize the tax benefits from the investment tax credit.

Secondly, the applicant correctly points out that the Staff's calculation of the deferred nuclear fuel balance resulted in a double deduction from rate base. The corrected allowance involving capital for deferred nuclear fuel should be \$8,773,000, on a jurisdictional level.

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

- (7) Through its rehearing application, the Office of Consumers' Counsel (OCC) alleges that the Commission's Opinion and Order of March 17, 1982 is unreasonable and unlawful in five major areas. Of the grounds set forth for rehearing only two points raise issues that merit further discussion.

First OCC contends that the Commission erred in selecting the first quartile of the Staff's recommended rate of return based upon the perceived riskiness associated with the Supreme Court's decision in *Consumers' Counsel v. Pub. Util. Comm.*, 67 Ohio St.2d 153 (1981). OCC contends that our decision in this case on rate of return violates the Supreme Court's decree by requiring CEI's ratepayers to pay for the terminated units. We must strongly disagree. The determination of the rate of return calculation was based upon empirical data presented by the company's rate of return witnesses. Although OCC's witness did not agree with this presentation it does not alter the fact that such data is observable. The Commission's task is, of course, to determine the investors' required rate of return, and the Commission must consider all factors relevant to that determination. The key issue in this case is whether the investors' perceived risk of an investment in CEI was altered by the Supreme Court's decision. We find that the data presented in this case demonstrates that it was.

Secondly, we find it necessary to make some additional comments with respect to the selection of a future test year. OCC contends that the use of updated projections filed by the company on December 18, 1981 constitutes a denial of due process (OCC assignment of error 5(e)). OCC contends that it was denied the opportunity to

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

review and analyze this data because of the timing of filing of such data in this proceeding. It should again be noted, however, that OCC did *not* request additional time to review this material or make discovery on this material during the hearing. In addition, although the material was not filed until December 18, 1981, the hearing did not start until January 4, 1982 and Mr. Zitzman, the company witness sponsoring the data, did not take the stand until January 11, 1982. Under the circumstances, we find that the time period was adequate for proper preparation. Thus, rehearing on this point must be denied.

- (8) The City of Cleveland (City) filed its application for rehearing citing twenty-one specific allegations of error. Many of the issues raised by the City deal with the adoption of the future test year. Review of the other assignments of error reveal that the majority represent nothing more than a restatement of the City's original position. Certain points, however, should be discussed.
- (9) The City of Cleveland's first assignment of error alleges that the Commission erred in accepting applicant's notice of its rate increase and its notice of public hearings. The basis of the City's argument is that the notices failed to specify that CEI was seeking to charge rates based upon a fully forecasted test year. Several comments are in order. As pointed out by the applicant in its motion to strike certain portions of the City's application for rehearing, there are procedural considerations which raise some doubt as to the timeliness of the objection and the standing of the City of Cleveland to raise the objection. Aside from these possible procedural questions,

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

the Commission must note that, contrary to the assertions of the City of Cleveland, we do not consider the adoption of the future test year as a "material change in the method of charging customers". If we were to recognize it as such, every time we changed or modified a particular method or policy that we had previously adopted we would be confronted with the same argument. Rehearing on this point must be denied.

- (10) By its twenty-first assignment of error the City of Cleveland contends that the Commission erred in failing to make a specific recommendation to the applicant regarding its time-of-day rate experiment. Although we do not find it appropriate at this time to make *any* specific recommendation concerning time-of-day rates, we do find that the company should continue its experiment and continue to file reports with Staff detailing the status of the experiment.

It is, therefore,

ORDERED, That the rehearing application filed April 16, 1982, by the Cleveland Electric Illuminating Company be granted to the extent provided above and denied in all other respects. It is, further,

ORDERED, That the rehearing application filed April 15, 1982, by the City of Cleveland be granted to the extent provided above and denied in all other respects. It is, further,

ORDERED, That the rehearing application filed April 16, 1982, by the Office of Consumers' Counsel be denied. It is, further,

**Rehearing Entry, PUCO Case No. 81-146-EL-AIR**

ORDERED, That copies of this Entry be served upon all parties of record.

**THE PUBLIC UTILITIES  
COMMISSION OF OHIO**

/s/ JON F. KELLY

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(Chairman)

/s/ MICHAEL DELBANE

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(Commissioner)

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(Commissioner)

Entered in the Journal  
May 12, 1982

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A True Copy

DAVID M. POLK

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David M. Polk  
Secretary

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

**Opinion and Order of the  
Public Utilities Commission of Ohio  
(Filed March 17, 1982)**

**BEFORE****THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company for authority to increase its  
filed schedules fixing rates and  
charges for electric service.

**Case No.  
81-146-EL-AIR**

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company to Recover Increases in the  
Public Utility Excise Tax on Gross  
Receipts by alternative methods than  
that provided by Case No. 81-1408-  
AU-UNC.

**Case No.  
81-1565-EL-UNC**

**OPINION AND ORDER**

The Commission, coming now to consider the above-entitled permanent rate application filed by the Cleveland Electric Illuminating Company pursuant to Section 4909.18, Revised Code; having reviewed the Staff Report of Investigation issued pursuant to Section 4909.19, Revised Code; having appointed its attorney examiner, Joseph P. Cowin, pursuant to Section 4901.18, Revised Code, to conduct a public hearing and to certify the record thereof directly to the Commission; having reviewed the testimony and exhibits introduced into evidence at the public hearing, which commenced December 17, 1981, and concluded February 1, 1982, and its prior Entries and Orders in these dockets; and being otherwise fully advised in the premises, hereby issues its Opinion and Order.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Appearances:**

Messrs. Alan D. Wright, Vice President of Legal and Public Affairs, and Craig I. Smith, Senior Counsel, The Cleveland Electric Illuminating Company, 55 Public Square, Cleveland, Ohio, 44115, and Messrs. Squire, Sanders & Dempsey, by Messrs. Alan P. Buchmann and Richard W. McLaren, Jr., 1800 Union Commerce Building, Cleveland, Ohio 44115, on behalf of the Applicant.

Mr. William J. Brown, Attorney General of Ohio, by Messrs. Marvin I. Resnik, Harris S. Leven and Donn D. Rosenblum, Assistant Attorneys General, 375 South High Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Mr. William A. Spratley, Consumers' Counsel, by Mr. Martin J. Marz and Ms. Deborah A. Ballam, Associate Consumers' Counsel, 137 East State Street, Columbus, Ohio 43215, on behalf of the residential consumers of The Cleveland Electric Illuminating Company.

Mr. James E. Young, Director of Law, City of Cleveland, by Mr. Craig A. Glazer, Assistant Director of Law, Room 106, City Hall, 601 Lakeside Avenue, Cleveland, Ohio 44114, on behalf of the City of Cleveland and the citizens of the City of Cleveland.

Mr. Joseph Meissner, Cleveland Legal Aid Society, 1223 West Sixth Street, Cleveland, Ohio, 44113, on behalf of the Senior Citizens Coalition, Greater Cleveland Welfare Rights Association and Western Reserve Alliance.

Bell and Randazzo Co., LPA, 21 East State Street, Columbus, Ohio 43215, by Messrs. Langdon D. Bell, Samuel C. Randazzo and John W. Bentine, on behalf of the Industrial Electric Consumers.

**History of the Proceedings:**

The Cleveland Electric Illuminating Company (hereinafter referred to as CEI, the applicant, or the company)

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

is an Ohio corporation engaged in the business of supplying electric service in this state. The service area to be included in this application for an increase in rates is located in the northeast corner of the State of Ohio and extends nearly 100 miles along the south shore of Lake Erie with an average width of 17 miles, bounded on the east by the Pennsylvania-Ohio border and on the west by the western limits of the cities of Avon and Avon Lake. The service area to be included in this application comprises an area of approximately 1,700 square miles with an estimated population of 2 million and includes 148 communities, primarily in the five counties of Ashtabula, Cuyahoga, Geauga, Lake and Lorain, and to a limited extent in the counties of Medina, Portage, Summit and Trumbull, all in the State of Ohio. As a public utility and an electric light company within the definitions of Sections 4905.02 and 4905.03(A)(4), Revised Code, the applicant is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code. The company's present rates for electric service were established by this Commission in *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR, Opinion and Order, May 4, 1981.

On January 30, 1981, CEI served and filed a notice of its intent to submit a permanent rate increase application pursuant to Section 4909.18, Revised Code, as required by Section 4909.43 (B), Revised Code, and Rule 4901-1-36 of the Ohio Administrative Code (hereinafter O.A.C.). As a part of this prefiling notification, the applicant requested that March 31, 1981 be fixed as the date certain for the valuation of property and that the twelve months ending December 31, 1982 be established as the test period for the analysis of accounts. By Entry of March 4, 1981, the Commission approved the requested date certain of March 31, 1981. By this same Entry the Commission neither ap-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

proved nor denied pursuant to Section 4909.15(C), Revised Code, the request of the applicant for the use of a fully projected test year in this proceeding. Rather, the Commission directed the applicant to file its application and supporting exhibits on the basis of a test period with the approved date certain as the midpoint as well as on the basis of the fully projected test year. Thus, the applicant was directed to file information required by the Standard Filing Requirements on the basis of the "traditional" test year beginning October 1, 1980 and ending September 30, 1981 and the fully forecasted test year commencing January 1, 1982 and ending December 31, 1982. The date certain of each test year was established as March 31, 1981. By application filed April 3, 1981 the applicant requested a waiver of certain of the Commission's Standard Filing Requirements. The Commission granted the request by Entry of April 14, 1981.

On April 22, 1981 the Office of Consumers' Counsel (hereinafter OCC) filed a motion to intervene in this proceeding. In addition, by motion filed May 4, 1981 OCC requested that this Commission reconsider its Entry of March 4, 1981 in so far as it allowed the filing of information based upon a fully projected test year. By Commission Entry of June 17, 1981 the petition to intervene filed by OCC<sup>1</sup> was granted and the motion for reconsideration of the March 4, 1981 Entry was denied.

The company filed its application on May 5, 1981. By Entry of the Commission dated May 27, 1981 the application was accepted for filing as of May 5, 1981. By this same Entry the Commission found that the proposed notice for publication complied with the requirements of Section 4909.18(E), Revised Code, and approved the

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<sup>1</sup>It should be noted that OCC's Petition to Intervene was also approved by Attorney Examiner's Entry of May 8, 1981.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

notice for publication. On May 20, 1981 OCC filed an objection to the proposed notice submitted by the applicant. On June 3, 1981 OCC filed an application for rehearing of the May 27, 1981 Entry of the Commission with respect to the approval of the proposed notice form submitted by the company. This application for rehearing was denied by Commission Entry of July 1, 1981.

On July 2, 1981 the applicant filed a motion to amend the form of notice approved for publication by Entry dated May 27, 1981. The need for amendment arose because the approved form of notice detailed changes proposed to those rates which were in effect on May 6, 1981. However, the company revised those rates on June 10, 1981 consistent with the Commission's Entry *Nunc Pro Tunc* in Case No. 80-376-EL-AIR, dated June 3, 1981, which corrected arithmetic errors in the Commission's Opinion and Order of May 4, 1981. This motion was granted by Commission Entry of July 31, 1981 and notice of the application was published pursuant to Section 4909.18, Revised Code (CEI Ex. 17).

As stated previously OCC filed a petition to intervene on April 22, 1981 which was granted by Commission Entry of June 17, 1981. Other parties also filed for intervention in this matter. On March 9, 1981 the City of Cleveland filed for intervention in these proceedings which was granted by Attorney Examiner's Entry of May 8, 1981. On June 4, 1981 the Industrial Electric Consumers<sup>2</sup> (hereinafter IEC) filed for intervention in this proceeding. This request was granted by Entry of July 10, 1981.

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<sup>2</sup>IEC's members consisted of the following at the time the hearing started: Air Products and Chemicals, Inc., Aluminum Company of America, Elkem Metals Company, General Motors Corporation, Jones & Laughlin Steel Corporation, Kennecott Corporation, and Union Carbide Corporation (Tr. 2, p. 5).

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

On November 27, 1981, the Senior Citizens Coalition, the Greater Cleveland Welfare Rights Organization, Inc., the Western Reserve Alliance, and the North Shore Alert filed a petition to intervene in this matter. By Entry of December 14, 1981, the attorney examiner denied the petition of the North Shore Alert to intervene and granted limited intervenor status to the other three groups. The denial of the petition to intervene of the North Shore Alert and the limitation placed upon the other three groups is consistent with the action taken by this Commission in CEI's last electric rate case, No. 80-376-EL-AIR, *supra*. As we stated there, the limitation placed upon the North Shore Alert was based on the fact that the North Shore Alert's stated purposes are "educational activities, actions, rallies, and demonstrations protesting the use of nuclear energy and promoting safe energy" and that this Commission is not the proper forum in which to entertain arguments over the desirability and safety of nuclear power. See *Northern States Power Co. v. Minnesota*, 447 F. 2d 1143, Aff'd 405 U. S. 1035, and *Cleveland v. Pub. Util. Comm.*, 64 Ohio St. 2d 209 (1980). The granting of limited intervention to the three residential sub-classes, namely the Senior Citizens Coalition, the Greater Cleveland Welfare Rights Organization, Inc. and the Western Reserve Alliance, was based upon the fact that Consumers' Counsel had already been granted intervenor status to represent residential customers.<sup>3</sup> However, the attorney examiner recognized that these three residential sub-classes had a specific interest in the rate design area which was different than that which Consumers' Counsel, representing a broader spectrum of residential customers, chooses to advocate.

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<sup>3</sup>To the extent that members of these three sub-groups resided in Cleveland, the City of Cleveland, an intervenor, had also been authorized to represent residential customers.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Therefore, the Senior Citizens Coalition, the Greater Cleveland Welfare Rights Organization, Inc., and the Western Reserve Alliance were granted limited intervention to pursue rate and tariff design issues. It should be noted that none of these groups took exception to these rulings by filing an interlocutory appeal pursuant to the provisions of Rule 4901-1-15, O.A.C. It should also be noted that the Commission's identical action in Case No. 80-376-EL-AIR, *supra*, was recently upheld by the Supreme Court of Ohio. *Senior Citizens Coalition v. Public Utilities Commission*, 69 Ohio St. . . . ( 1982).

By attorney examiner's Entry dated December 24, 1981 the participation of the four groups referenced above was further limited. On December 9, 1981 these groups filed jointly a series of objections to the Staff Report of Investigation, pursuant to Section 4909.19, Revised Code, and Rule 4901-1-28, O.A.C. By Entry of December 24, 1981 the attorney examiner struck from the record all of the objections filed by these groups dealing with issues other than rate design. Again it should be noted that the parties affected had the right to file an interlocutory appeal on this issue to the Commission pursuant to Rule 4901-1-15, O.A.C., but failed to avail themselves of such a remedy.

In accordance with the provisions of Section 4909.19, Revised Code, the Staff of the Commission conducted an investigation of the matters set forth in the application. A written report of the results of the Staff investigation was filed November 12, 1981, and was served as provided by law. Objections to the Staff Report were timely filed by the applicant, Consumers' Counsel, IEC, the City of Cleveland, and Senior Citizens, et al.

Amended House Bill No. 694, as amended by substitute House Bill No. 552, became effective on November 15, 1981. This law, among other things, increased the rate of taxation for excise taxes on gross receipts payable by

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Ohio utilities in 1982 and subsequent years, from 3.35% to 3.60%; imposed an additional temporary increase in the tax rate of .25% on the annual excise tax statement required to be filed on or before August 1, 1982; and required the payment of an additional surtax of approximately .21%.

By Entry dated December 23, 1981 in Case No. 81-1408-AU-UNC this Commission approved the applications for a surcharge tariff to recover the .71% surcharge for many Ohio utilities, including the applicant in this case. By application dated December 15, 1981, the Cleveland Electric Illuminating Co. filed for alternative treatment under finding (5) of the Commission's Entry of November 25, 1981 in Case No. 81-1408-AU-UNC, to further increase the surcharge to account for the repeal by the legislature of the Charter City Credit (Section 5727.44, Ohio Revised Code). This application has been assigned Case No. 81-1565-EL-UNC and has been consolidated with Case No. 81-146-EL-AIR for resolution. This subject will be discussed under the appropriate section of operating income. The consolidation was executed by the attorney examiner during the hearing (Tr. II, p. 118, 119).

Pursuant to the Commission's Entry of November 25, 1981, the public hearing was scheduled to commence on Thursday, December 17, 1981. The Commission directed the applicant to cause to be published a notice of the hearing at least fifteen days prior to the December 17, 1981 hearing. Notice of the application was published pursuant to Section 4909.18, Revised Code and notice of the hearing was published in accordance with the Commission's November 25, 1981 Entry (See CEI Exs. 17 and 17A). The first day of hearing was held, as scheduled, on December 17, 1981 at City Hall in Cleveland, Ohio, to afford members of the public affected by this case the opportunity to present statements concerning the proposed increase. The

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

hearing was conducted before Chairman Jon F. Kelly and Commissioner Dennis S. Pines. Seventeen members of the public, including the Honorable George Voinovich, Mayor of Cleveland, gave testimony at the public hearing. The hearing reconvened on Monday, January 4, 1982 at the offices of the Commission, 375 South High Street, Columbus, Ohio, and concluded on Monday, February 1, 1982. Briefs were filed by all parties on February 10 and February 17, 1982. The recorded transcript of the proceeding and the exhibits admitted into evidence during the 20 days of hearing have now been certified to the Commission by the examiner for its consideration.

**Commission Review and Discussion:**

This case comes before the Commission upon the application of The Cleveland Illuminating Company pursuant to Section 4909.18, Revised Code, for authority to increase its rates and charges for electric service to its jurisdictional customers. The company alleges that its existing rates are insufficient to provide it reasonable compensation for the service it renders customers affected by these proceedings and seeks Commission approval of rate schedules which would yield some \$134,834,473 in additional gross annual revenues based on its analysis of the the test year ending September 30, 1981 and some \$135,293,271 in additional gross annual revenues based on its analysis of calendar year 1982 test year operations (CEI Ex. 1D, p. 3 and 1E, p. 3). It now falls to the Commission to evaluate the evidence of record in order to determine if the applicant's existing jurisdictional rates are inadequate. In the event the company is found to have sustained its burden of proof with respect to these matters, the Commission must then establish rates which will afford the company the opportunity to earn a fair rate of return.

## Opinion and Order, PUCO Case No. 81-146-EL-AIR

## RATE BASE

The company, the Staff, and Consumers' Counsel offered testimony and submitted exhibits in support of their respective rate base proposals in this proceeding. The following table compares the company's, the Staff's and OCC's estimates of the value of the applicant's property used and useful in rendering service affected by this proceeding as of the date certain, March 31, 1981. The adjustments to these proposals will be discussed below.

## Jurisdictional Rate Base Summary

	<u>Applicant<sup>1</sup></u>	<u>Staff<sup>2</sup></u>	<u>OCC<sup>3</sup></u>
Plant in Service ....	\$2,415,137,486	\$2,416,500,672	\$2,416,501,000
Less: Depreciation Reserve .....	<u>552,886,296</u>	<u>555,715,561</u>	<u>555,716,000</u>
Net Plant in Service .....	1,862,251,190	1,860,785,111	1,860,785,000
Plus: CWIP .....	40,662,345	40,595,980	40,596,000
Working Capital .....	178,281,563	84,062,000	60,661,000
Less:			
Contributions Deferred Income Taxes .....	-0-	-0-	-0-
Taxes .....	-0-	101,758,285	101,758,000
Other Items ..	-0-	-0-	3,065,000
	<u><u>\$2,081,195,098</u></u>	<u><u>\$1,883,684,806</u></u>	<u><u>\$1,857,219,000<sup>4</sup></u></u>

<sup>1</sup>Company Ex. 1-D, Revised Schedule B-1

<sup>2</sup>Staff Report, Schedule I-7

<sup>3</sup>OCC Exhibit 2, Schedule RB-1 and OCC Ex. 2A

<sup>4</sup>Variations in addition results from rounding figures.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Allocations:**

The methods of allocation proposed by the applicant and reflected in its B-6 Schedules are generally the same methods used by the applicant and determined to be reasonable by this Commission in CEI's prior cases. The Staff reviewed these methods and found, with one exception, that the underlying basis of these methods and the methods themselves were acceptable for ratemaking purposes (Staff Report, p. 4).

The exception on which the Staff and the company differed was with respect to certain land in Account 381. The Staff used a zero allocation factor for this account and the company objected (CEI Objection 23). CEI witness Blank addressed this objection (CEI Ex. 6A, pp. 7, 8). Mr. Fox, testifying on behalf of the Staff, conceded that Mr. Blank was correct and that the \$150,033 should be included in plant in service (Staff Ex. 8, p. 8). The Commission finds that the company's objection is well made and that the \$150,033 should be included in plant-in-service.

**Plant In Service**

There were some minor discrepancies between the Staff's calculation of plant in service and that of the various parties in these proceedings. As pointed out by the City of Cleveland, there was a slight error on Staff Schedule I-8.1 where the Staff used jurisdictional amounts for its adjustments instead of total company amounts (City of Cleveland Ex. 8, p. 12). The City of Cleveland claims an adjustment should be made in the amount of \$47,161, whereas Mr. Fox acknowledges an error, but submits an amount of \$47,201. We will adopt the figure recommended by Mr. Fox and find that plant in service should be reduced by this amount.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Company witness Moore also testified that an exclusion from plant in service in the amount of \$954,198 should be made to reflect the applicant's share of new common facilities at the Beaver Valley generating station in order to be consistent with this Commission's order in *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR, Opinion and Order, July 10, 1980. This adjustment also reflects a reduction for two jobs that were found not to be in service. Mr. Fox agreed with this adjustment (Staff Ex. 8, p. 43). We find that the adjustment is fully supported by the record and should be implemented.

The Staff excluded from rate base certain facilities at the Elden Substation (Staff Report, p. 29). Company witness Moore testified that although the three recloser foundations and a tie breaker structure were not in service at date certain, the cost of construction should be included in rate base because it was relatively low and these facilities were built in conjunction with a needed foundation (CEI Ex. 3A, p. 5). It can be seen that the adjustments proposed by the Staff are similar to adjustments that have been approved by this Commission in previous cases. Mr. Moore acknowledges that these projects were not in service at date certain. We, therefore, find that plant in service should be reduced in the amount of \$6,543.

The Staff also conducted a selective sample of 20 land parcels owned by the applicant. The Staff recommends that certain portions of these land parcels be excluded from plant in service as not used and useful. The recommendations were based on normal acreage requirements to adequately support each installation. Consideration was given to additional acreage to meet safety and environmental requirements. The Staff recommends that portions of six parcels listed on Schedule I-8.2 should be excluded. These

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

parcels are identified by the applicable plant accounts as identified by Mr. Moore as follows (CEI Ex. 3A, p. 6):

<u>Account</u>	<u>Location</u>	<u>Exclusion</u>	
		<u>% Acreage</u>	<u>Part of Original Cost</u>
360-10	Keppler Sub .....	18	\$ 48,214
360-10	Quaker Sub .....	64	2,687
360-10	Buckeye Sub .....	14	1,347
389-14	Mayfield Serv. Ctr. ....	29	46,961
389-16	Parma Radio Station ..	31	631
	Subtotal .....		\$ 99,840
320	Davis-Besse .....		25,914
	Total .....		\$125,754

Mr. Moore disagreed with the Staff's adjustments for three reasons. First, Mr. Moore contended that the approach used by the Staff was subjective in nature with no guidelines set forth as to the basis of the ultimate decision. Second, Mr. Moore claims that an unreasonable burden has been placed upon the company by charging the company with perfect hindsight. Third, Mr. Moore objects to the Staff's technique because it uses the same average cost for all portions of the site which ignores the fact that the property is usually available on an all or nothing basis (CEI Ex. 3A, p. 7). Mr. Moore went on to testify with respect to the specific parcels of land and why they should be included in rate base. Mr. Fox responded generally to Mr. Moore's discussion of the issue although not specifically on a parcel by parcel basis (Staff Ex. 8, pp. 4-7).

With respect to the Keppler Substation parcel of land, we find that the Staff properly excluded its value of \$48,214 from rate base. We do not dispute the wisdom of

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

the company in purchasing the property but find that Mr. Moore's testimony clearly indicates that it is plant held for future use (CEI Ex. 3A, p. 8). We are of the opinion that the same is true for the Mayfield Service Center property, at a cost of \$46,961, which we determined to be properly excludable from rate base in the last CEI rate case. Both of these amounts are properly excluded from plant in service.

The company's basic objection with respect to the three remaining parcels of land is that the parcels in question have been acquired by the company in connection with other property that has been found to be useful by the Staff. An issue arises concerning these parcels because the company contends that the necessary portion of the property purchased could not have been acquired without also purchasing the portion excluded by the Staff. In addition, the company objects to the fact that the Staff took an average price per acre for an entire lot and applied the average to the amount excluded, totally disregarding the variations in value that result from size, terrain, or access (CEI Initial Brief, p. 2).

In determining this issue we find it difficult to come to the conclusion that this land is used and useful in providing utility service to CEI's customers. At the same time, however, under these circumstances we must sympathize with the company's position that this land should not be valued on an average price basis. This is an issue similar to one presented in *Cincinnati Gas and Electric Company*, Case No. 81-66-EL-AIR, *et al.*, Opinion and Order, January 27, 1982, regarding the East Bend Station. At that time we found that the property was not used and useful; however, there was no evidence of record to substantiate a different basis of evaluating the land. We are faced with the same situation here and again must come to the same

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

conclusion. We have no evidence of record to assign a different value to the land in question. Therefore, we must find that the Staff properly excluded the amounts in question.

The company also takes exception to the exclusion by the Staff of a portion of the Davis-Besse Power Plant site (Staff Report, Schedule I-8.2). Mr. Moore testified at length on the usefulness of the piece of land (CEI Ex. 3A, p. 11). Upon review of the record we find that this land is used and useful in providing service to CEI's customers and should be included in rate base in the amount of \$25,914.

The City of Cleveland has addressed a few other issues which deserve some comment. First, the City asks this Commission to disallow AFUDC on CWIP Job Order 1976 1WW which is a construction project concerning wastewater treatment. The City bases this request on allegations made in a law suit filed against the company by the State of Ohio (City of Cleveland, Ex. 5). We must remind the City that these are *allegations* and we find that no action by this Commission can be based upon mere allegations.

The City has also made various objections to this Commission's treatment of Davis-Besse in light of Davis-Besse's past performance (City of Cleveland Objections 38-40). However, the City did not pursue these objections at hearing and did not address them on brief. We find that these objections are not well made and are overruled.

As a final point the City has also made a recommendation that an adjustment should be made for Lakeshore 18 Plant outages (City of Cleveland Initial Brief, p. 28). However, this subject was only mentioned at the hearing and the City makes no specific recommendations. We find such a proposal unwarranted.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Completed Construction Not Classified (CCNC):**

The City has objected to including all of Account 106, completed construction not classified (CCNC), in plant in service. In particular, the City contends that expense dollars contained in CCNC at date certain should be removed. CEI agrees with this latter contention, and its Witness Moore has proposed such an adjustment (CEI Ex. 3A, p. 4). The Commission reviewed a similar situation in CEI's recent steam case, and found that CCNC was properly includable in rate base, but that expense dollars should be deducted. *Cleveland Electric Illuminating Company*, Case No. 81-41-HT-AIR, Opinion and Order, January 13, 1982.

The Staff believes that CCNC should be included in rate base, but disagrees with the necessity of analyzing Account 106 to eliminate expense dollars. As Staff Witness Fox explained, it is reasonable to find expense dollars in CCNC as this is expected under the Uniform System of Accounts. Furthermore, as long as expense dollars are not allowed to remain in Account 106 for an inordinate length of time, the expense dollars are relatively few and the Staff feels that there is no real value in estimating them (Staff Ex. 8, pp. 41, 42; Tr. XIV 139, 140, 186, 194-196). The Staff thus believes that Mr. Moore's proposed adjustment to eliminate expense dollars is unnecessary. Upon review of the record we find that CCNC should be included in rate base. However, we find that Mr. Moore's proposed adjustment to eliminate expense dollars from this amount is proper and should be adopted. Certainly, in a situation where the company is agreeing with a reduction in rate base, the Commission should not dissuade such adjustments.

The City of Cleveland raises a second issue with respect to CCNC, although we are not completely sure

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

what action the City would have us take. The City appears at one point to be arguing that the cost of removal should be eliminated from plant in service (City of Cleveland Initial Brief, p. 21). However, the City concentrates its arguments on the federal income tax implications of the selection of a specific cost of removal.

With respect to the determination of rate base, Mr. Moore testified that it made no difference whether the cost of removal remained in Account 106 as part of plant in service or whether it was transferred to Account 108, Depreciation Reserve. The effect of either choice produces the same rate base result (CEI Ex. 3A, p. 4). We find we must agree that this is simply not a rate base issue.

We must also agree, however, with the City of Cleveland that the selection of a particular number for the cost of removal will have an impact on the calculation of the federal income taxes expense used for ratemaking purposes and, thus, on test year expenses. The selection of the particular number, in turn, depends over which point in time the analysis is being performed. To illustrate this point it can easily be seen that the Staff used one figure for cost of removal in determining the federal income tax expense for Period I and another figure in developing a corresponding expense for Period II (Staff Report, Schedule 1-4.1, Schedule II 4.1).

The City of Cleveland contends that the cost of removal that should be used in determining federal income taxes should be \$3,940,031 (City of Cleveland Initial Brief, p. 24). The City contends that this is the appropriate number without referencing which test period is to be employed or which time period the \$3,940,031 represents. The company takes exception to this and submits a separate number for Period I and Period II federal income tax calculations. We find that we must disagree with the City of Cleveland that \$3,940,031 is the appropriate

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

number; the number to be utilized does, in fact, turn upon which time period is being considered.

Mr. Jirousek testified on behalf of the company regarding the calculation of the federal income tax expense for Period I and Period II. Mr. Jirousek testified that the appropriate cost of removal figure to be utilized in calculating federal income taxes is the estimated removal costs for jobs which go in service during the test year (Tr. 5, p. 52-53). Mr. Jirousek stated that by the term "go in service" he is indicating when the job gets classified from Account 106, completed construction not classified, to Account 101, plant in service (Tr. 5, p. 61). At the point where the job is transferred from one account to the other a job closeout distribution is prepared. Mr. Jirousek emphasized that he was focusing on an accounting change and *not* when the plant actually starts operating, in determining a removal cost figure for tax purposes. The property that is actually transferred from Account 106 to Account 101 is the property that determines a removal cost figure for tax purposes. This figure will, of course, be different from one year to the next, and Mr. Jirousek testified that he used the different figures in calculating Period I taxes and Period II taxes (Tr. 5, pp. 52-53).

The City of Cleveland concentrates on the testimony of Mr. Moore on this issue. Mr. Moore testified to a figure for removal costs as of date certain. Mr. Jirousek testified that the figure Mr. Moore was referring to was an estimate of the removal costs associated with all jobs *open* on the date certain (Tr. 5, p. 53). There is distinction to be drawn between the jobs open on date certain and the jobs expected to go into service during a given test year. As stated previously, Mr. Jirousek testified that the relevant point in his analysis of going into service is not when the plant begins operating but when the plant is transferred from Account 106 to Account 101. It can

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

be surmised that this figure may not correspond to the figure stated as an estimate of all jobs open at a given point in time, such as date certain. We find, therefore, that the appropriate figure to be used for tax purposes is the \$3,468,000 corresponding to Period II.

**Excess Capacity:**

The City of Cleveland and OCC both objected to the Staff's failure to propose an adjustment to rate base for excess capacity (OCC Objection 6, City of Cleveland Objection 42). City of Cleveland witness Miller recommended that the Commission recognize the alleged excess capacity by adjusting rate base to reflect the removal of Eastlake Unit No. 4 (City of Cleveland Ex. 8A, p. 9).

The Staff and the company oppose such an adjustment. Staff witness Fox testified that Schedule I-8.3 of the Staff report indicates that the applicant may have had excess capacity during the 1981 test year, but that it is not expected to have excess capacity in 1982 or 1983 when the rates resulting from this proceeding are expected to be in effect (Staff Ex. 8, p. 32). Mr. Fox emphasized that the Staff exercises judgment in these determinations aimed at influencing certain actions by the applicant and not towards penalizing it for what was good judgment at the time it was made. The rather small indication of possible excess capacity in the test year, in view of the expectations in 1982 and 1983, plus the Staff's knowledge of the applicant's own economic studies, led Mr. Fox to conclude that an adjustment would be unnecessary. We find we must agree with the Staff's position and overrule OCC's and the City's objections on this point.

In making this determination we must point out that we have previously explained the conceptual problems associated with a rate base adjustment for excess capacity.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

(See, e.g., *Dayton Power and Light Company*, Case No. 81-21-EL-AIR, Opinion and Order, February 3, 1982). It is obvious that it is impossible for a company to add increments of capacity at a rate which will precisely match the increase in demand over a period of time. Capacity is added in large incremental amounts which may lead to a possible excess in capacity at a given point in time. A specific recommendation on a reduction in rate base, however, must be judged against the reasonableness of the actions taken by the company. Upon review of the record we must conclude no adjustment is warranted.

**CWIP:**

The applicant has proposed that approximately \$40,000,000 of CWIP projects be included in rate base. The Staff has investigated the projects and, with the exception of one project of a relatively minor dollar amount, has determined that the applicant's CWIP projects are eligible for rate base treatment (Staff Report, p. 32, 148-150). The one project excluded is replacement and maintenance work which, in the Staff's view, is not properly CWIP for rate-making purposes (Staff Ex. 8, pp. 12, 13). CEI witness Moore argues that this project provides for increased reliability and increases in load and, therefore, should not be excluded (CEI Ex. 3A, p. 12). The Commission has considered similar projects in the past and has excluded them. We find that the project in question should also be excluded in this case.

The Office of Consumers' Counsel and the City of Cleveland objected to including any CWIP in rate base (OCC Objection I(A)(1), City of Cleveland Objections 44, 45, 46). We find this position to be unreasonable and overrule these objections.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Depreciation Reserve**

Section 4905.05(H), Revised Code requires that the Commission determine the proper and adequate reserve for depreciation to be deducted from the original cost of the applicant's used and useful property. The Staff, as part of its investigation, tested the company's book depreciation reserve level against a theoretical reserve level and determined that the actual booked reserve was within reasonable limits of the theoretical reserve (Staff Report, p. 31). However, there were a few adjustments to depreciation reserve recommended by the Staff which are discussed below.

The Staff adjusted the actual reserve to reflect six months of the incremental increase in depreciation expenses resulting from the Commission's approval of new accrual rates in Case No. 81-839-EL-AAM, Entry dated October 28, 1981 (Staff Ex. 8, p. 36). CEI has objected to the Staff's adjustment to depreciation reserve (CEI Objection 24). The company contends that increasing the depreciation reserve by this amount unreasonably reduces the net plant base by imputing depreciation that was not recovered in rates paid by customers. CEI further argues that this practice results in the company's investors being denied the opportunity to earn an adequate level of return (CEI Ex. 10A, p. 5-7).

The rationale behind the Staff's adjustment and the arguments raised by CEI have been previously presented to the Commission, and the Commission has consistently approved the rate base adjustments to reflect new accrual rates. *Dayton Power and Light*, Case No. 80-687-EL-AIR, Opinion and Order, July 15, 1981, and *Cleveland Electric Illuminating*, Case No. 80-376-EL-AIR, Opinion and Order, May 4, 1981. The Staff points out that CEI is in favor of recognizing updated accrual rates for expense

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

purposes even though it objects to such recognition for rate base purposes (CEI Ex. 10A, p. 7). At the risk of repeating ourselves, the Commission would indicate that Section 4909.05(H), Revised Code, contemplates adjustments to booked reserve in appropriate circumstances and that depreciation reserve should match date certain net plant. Whether or not the amount of depreciation expense has been recovered through prior rates is of no concern when establishing prospective rates. Because depreciation expense will be based on the newly authorized accrual rates the depreciation reserve should be adjusted accordingly. We will overrule the applicant's objection.

The applicant has also proposed to reduce depreciation reserve by deducting therefrom the accrued depreciation for Bruce Mansfield Unit No. 3 as of date certain in the amount of \$1,878,712 (CEI Ex. 10, p. 4). The rationale for this adjustment is that depreciation expense for Bruce Mansfield was not an element of rates until May 6, 1981, after the date certain, and thus the accrued depreciation is shareholder rather than ratepayer funded capital (CEI Ex. 10, p. 4; CEI Ex. 10A, pp. 3-5). The Staff opposes this adjustment (Staff Ex. 8, pp. 9-11). As we stated above the amount for depreciation expense which has or has not been recovered through prior rates is irrelevant for the purposes of determining the appropriate reserve for ratemaking. We find the Staff's adjustment to be appropriate and overrule the company's objection on this point.

**Working Capital**

The applicant, the Staff, and Consumers' Counsel have each proposed an allowance for working capital to be included in the rate base valuation in accordance with the provisions of Section 4909.15(A)(1), Revised Code. Intervenor City of Cleveland, through its witness Philip E.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Miller, also presented recommendations for the treatment of specific components of working capital. The company has requested an allowance of \$178,281,563 based upon its version of the formula method (CEI Ex. 1D, Schedule 3-5). The Staff recommends an allowance of \$84,062,000, also based upon the formula method (Staff Report, Schedules I-11 and II-11). It should be noted, however, that the Staff did make some adjustments to this figure through the testimony of Mr. Fox (Staff Ex. 8). Issues have been raised with respect to virtually every component of the working capital formula.

**Cash Component**

The cash component of working capital, as calculated by the Staff, represents one-eighth of adjusted operation and maintenance expenses, excluding fuel and purchased power, plus an allowance for the lag in the recovery of fuel expense (Staff Report, p. 32). This is part of the basic formula approach utilized by the Staff in all utility rate cases. In this case, however, adjusted operation and maintenance expenses will be determined on the basis of the projected operating period ending December 31, 1982. As a result, an issue arises with respect to the use of projected data in determining the amount of working capital to be included in rate base.

Section 4909.15(A)(1), Revised Code, sets forth the applicable statute which provides for the determination of a working capital component. In applying this statute, the Commission has utilized traditional test year data, centered on the date certain, to determine a level that was representative for ratemaking purposes. Although we have not stated that working capital must be determined as of date certain, we feel that the use of date certain as a reference point is appropriate.

In the instant case we are adopting the use of the Period II operating income data. This data represents the

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

projected income and expense figures for the year ending December 31, 1982. Date certain in this case, as stated previously, is March 31, 1981. We are of the opinion, given these facts, that the use of Period II projected operation and maintenance expense for the determination of a cash working capital component would be inappropriate.

The only other information that we have for the determination of a cash component of working capital is the figures presented by the Staff and the company on Period I (Staff Report, p. 5). The figures presented by the applicant, however, contain expense items that we find inappropriate for ratemaking purposes. As a result, we find it is appropriate to utilize the Staff's adjusted recommendation for Period I for the determination of the cash component of working capital.

Consumers' Counsel and the City of Cleveland also objected to the Staff's inclusion of a fuel expense lag in the working capital allowance. Staff witness Montgomery explained that the Staff has always recognized a fuel expense lag but that in the past it has not been recognized in the calculation of working capital. Instead, the Staff indicated that it was recognized in the cost of service since fuel revenues were less than fuel expenses (Staff Ex. 5, p. 24). Under Chapter 4901:1-11, O.A.C., fuel revenues and fuel expenses are synchronized. It is, therefore, now necessary to expressly recognize the fuel expense in working capital. We have recently found that such an adjustment is appropriate (*See Cincinnati Gas & Electric, supra*).

CEI and the Staff initially disagreed with respect to the proper treatment of this item. CEI pointed out certain math errors in the Staff's calculation and Staff witness Montgomery agreed (Staff Ex. 5, p. 11). The company has recommended that Mr. Montgomery's calculation regarding the eight day fuel lag be adopted. We find that this adjustment is appropriate.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Materials and Supplies:**

Much confusion surrounded the determination of a materials and supplies component for working capital. The basic issue with respect to this component is the method to be used in determining a proper level. A secondary issue is whether "betterments" are to be included in the component derived.

Mr. Chopp discusses the inclusion of "betterments" in the materials and supplies component of working capital (CEI Ex. 5A, p. 16). Mr. Chopp states that since the funds used to maintain the betterments portion of materials and supplies are investor supplied dollars, it is only right and fair that investors be allowed to earn a return on this investment (CEI Ex. 5A, p. 16). The term "betterments" refers to that portion of materials and supplies held for new construction, additions, or extensions. This Commission has removed betterments in each of CEI's last three rate cases and finds it appropriate to do so again. It should be noted that the company submitted its materials and supplies request excluding that portion which would be attributable to the approximately two million dollars representing betterments. Therefore, no adjustment is necessary.

The analysis performed by the Staff to determine a materials and supplies component consisted of the use of a 13-month average balance of materials and supplies held for normal operations and repair purposes (Staff Report, p. 32). These figures were provided by the company to the Staff pursuant to Staff Data Request #53 which was identified at the hearing and marked as Staff Exhibit 8A. The Staff used turnover ratios to determine the 13-month average materials and supplies component. The company objects (CEI Objection 28).

Staff witness Fox testified that until recently the amount of materials and supplies used for working capital

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

purposes was dependent mainly upon the judgment of various company witnesses of what would be a proper level. Mr. Fox points to sharp increases in this component over recent years and concludes that such increases are inconsistent with Staff expectations (Staff Ex. 8, p. 30). The Staff is of the opinion that the use of turnover ratios may be implemented to remove some of the subjective element in the determination of an appropriate level of materials and supplies. Mr. Fox points out that this is the only method presented in this proceeding that uses quantitative analysis rather than subjective evaluation to determine an appropriate level.

As indicated previously, in making an initial calculation the Staff attempted to utilize the data presented on Data Request #53 (Staff Ex. 8A). However, in doing so the Staff excluded CAPCO production materials and supplies through a miscommunication with the company on what data had actually been supplied. Upon revising the Staff's calculations using corrected data, Mr. Fox recommended that an amount of \$17,602,568, on a jurisdictional level, be used for materials and supplies (Staff Ex. 8, p. 31).

The company has gone to great lengths to contest the Staff's recommendation on this point. Company witness Frattin first attacked the use of a turnover ratio approach (CEI Ex. 14, p. 8). Mr. Frattin contends that the use of a ratio analysis does not take into consideration either emergency stock or restricted stock. In addition Mr. Frattin contends that the use of such a ratio analysis is too simplistic an approach. He argues that there are more desirable methods to be used.

Mr. Frattin also disagrees with the Staff's implementation of the turnover ratio analysis. He contends that the Staff has inconsistently applied this analysis in this case and that improper terms were used in the analysis (CEI Ex. 14, pp. 11-15).

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Upon review of the record we find that we must agree with the applicant and find that the proper level for materials and supplies is \$22,376,004.37 (CEI Ex. 14, p. 16). In making this determination, however, we do not reject the Staff's approach to the determination of this component in general; we find, rather, that its application in this particular case was in error. We are of the opinion that the Staff is correct in attempting to derive a method of applying a quantitative analysis as a basis for the determination of this component; however, the application in this particular case leads to an erroneous conclusion.

**Fuel Inventory:**

The Staff and the company disagreed on almost every component that went into calculating the fuel inventory figure for working capital purposes. Mr. Fox summarized the positions of the parties on page 15 of his testimony (Staff Ex. 8), which, when combined with changes made by Mr. Soucie yields the following table (CEI Ex. 13, Appendix I, Tr. 4, p. 117):

	<u>Applicant</u>	<u>Staff</u>
1. Coal Quantity _____	1,090,158 tons	612,999.67 tons
2. Coal Price _____ \$	44.95/ton	\$ 45.42/ton
3. Coal Element Cost \$	49,002,602	\$ 27,842,445
4. #2 Oil Quantity _____	4,194,094.00 gal.	4,491,741.10 gal.
5. #2 Oil Price _____ \$	1.03/gal	\$ 1.1016/gal.
6. #2 Oil Element Cost \$	4,319,917	\$ 4,948,102
7. #6 Oil Quantity _____	17,540,085.00 gal.	15,829,673.83 gal.
8. #6 Oil Price _____ \$	.90/gal.	\$ .7818/gal.
9. #6 Oil Element Cost \$	15,786,077	\$ 12,375,639
10. Total Cost (3+6+9) \$	69,108,596	\$ 45,166,186
11. Allocation Factor _ \$	.981212	.981212
12. Juris. Fuel Stock _ \$	67,810,184	\$ 44,317,603

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

The difference in the prices shown on lines 2, 5 and 8 are due to the applicant using the estimated price for December 31, 1981, while the Staff used the weighted average cost by generating station for March or March and April, 1981, as reflected in the applicant's response to Staff's Data Request No. 39. The only exception to the fuel costs shown on part 3 of Data Request No. 39 and the costs used by the Staff, is the cost of coal at the Mansfield station, which the Staff reduced to exclude the deferred cost of Quarto coal. Simply stated, the applicant used calendar year end costs while the Staff used date certain costs.

With respect to the proposed year end pricing, the Commission must again reject this approach as being inconsistent with the concept of a date certain rate base. See *Dayton Power & Light*, Case No. 78-92-EL-AIR, Opinion and Order, March 9, 1979, at p. 13. The Commission is of the opinion that purchase price is the relevant factor in determining a reasonable allowance for fuel inventory. It must be emphasized that the purpose of this exercise is to determine a reasonable level of funds that investors are required to provide at date certain for a normal level of fuel stock which is permanently needed in the ongoing operations of the utility. The Commission finds the Staff's use of date certain costs to be reasonable and appropriate in this regard. Such costs should not include the increased actual price of Quarto coal paid by CEI, which is attributable to the commercialization of the Quarto mine.

Another major difference between the parties concerns the quantities to be used in the various calculations. For #2 and #6 oil the applicant used the actual quantities in inventory at the March 31, 1981 date certain while the Staff used a 12-month average (CEI Ex. 13, p. 2; Staff

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Ex. 8, p. 16). For the purposes of this case we find the Staff's oil inventory figures to be appropriate.

The major difference between the parties with respect to fuel inventory is the amount of coal that should be included. As we have stated above, we feel the price component used by the Staff to be appropriate; however, further review is called for with respect to the quantity component.

Mr. Fox recommended that a 30.8 day supply of coal, or 612,999.67 tons, be utilized for working capital purposes (Staff Ex. 8, p. 15). Mr. Soucie, testifying on behalf of the company, initially recommended a 65 day supply, or 1,296,103.30 tons, but lowered his recommendation to 55 days, or 1,090,158 tons, including an allowance for Bruce Mansfield (CEI Ex. 13 p. 20). Mr. Fox testified that in making his recommendation he took note of the fact that CEI differs from other Ohio utilities in that the bulk of its coal requirement, about 80%, is transported by rail; of the remaining coal supply, about 8.5% is transported by truck and the remaining 11.5% is transported by river barges. The barges are used exclusively for the Bruce Mansfield Plant where the applicant has about a 20% ownership (Staff Ex. 8, p. 17). Mr. Fox testified that based simply on the fact that about 88.5% of the applicant's total requirements involve normal transportation times of nine days or less, significantly less than most Ohio electric utilities, the Staff is of the opinion that the applicant's requested supply level was excessive and needed to be reduced. Based upon these and other considerations and in light of Mr. Chopp's testimony, the Staff was of the opinion that it could not justify more than the 30.8 days supply level it was recommending in the Staff Report. It should be noted, however, that Mr. Fox did acknowledge

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

that the Staff underestimated the importance, and did not consider the value, of an adequate reserve as a bargaining tool in coal contract negotiations for coal contracts as well as freight contracts. Mr. Fox was of the opinion that the 30.8 day supply level recommended in the Staff Report could be increased to reflect this aspect if the applicant can quantify it (Staff Ex. 8, p. 18).

Mr. Soucie disagrees with the Staff's position. He testified that the staff's method only represents an attempt to formulate an approach by which to ascertain the adequacy of a coal inventory, but that this approach is incomplete and incomprehensive (CEI Ex. 13). Mr. Soucie states that contingencies other than transportation delay days must be considered. He testified that allowances for intangible and economic considerations must be made and that the physical and functional limitations of the company must be recognized. Mr. Soucie also testified that no matter how good a formula can be derived, it can only be used as a guideline to define the range of acceptable inventory levels. Management judgment and experience are still factors in any prudent inventory decision. Mr. Soucie emphasized that these factors are more valuable as a decision-making tool than is total reliance on a given formula.

Mr. Soucie testified that an absolute minimum coal requirement for the company would be a 40 day supply (CEI Ex. 13, p. 16). He testified that it was his opinion that the company would be extremely vulnerable, however, at this level. We are of the opinion that we must agree with the company's position on this point. We do not feel that a 30 day supply will provide an adequate buffer against all contingencies. We, therefore, find the company's proposal to be reasonable. We do find one adjust-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

ment to be appropriate, however. The company has recommended a 55 day coal supply; however, it has included a 65 day supply in its calculation of coal for Bruce Mansfield. We find that the Mansfield figure should also be put on a 55 day level. With that adjustment we adopt the company's recommendation on a coal inventory supply level.

**Deferred Quarto Coal:**

The applicant included an amount in working capital for deferred Quarto coal expenses. The Staff also included an amount; however, the Staff used a different method to calculate the amount. OCC and the City of Cleveland have objected to the inclusion of this item, with OCC suggesting as an alternative that the applicant could accrue interest on the deferred balance.

In the last CEI rate case, Case No. 80-376-EL-AIR, we determined that the inclusion of a working capital requirement for the Quarto deferral was appropriate for ratemaking purposes. At that time we approved the use of a 13 month average balance of deferred Quarto costs net of state and federal income tax effects. The figures we used in that case were based upon an average from December 1980 through January 1982.

The applicant in this case has recommended the use of a 13 month average balance based upon the time period when rates will be in effect in this case (CEI Ex. 5A, p. 21). The Staff in this case has made a recommendation based upon a 13 month average beginning December 1980 and ending with the budgeted January 1982 accumulated balance (Staff Ex. 5, p. 16, 17). The applicant points out that the use of a 13 month average was approved in CEI's last rate case and that this average was based upon

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

the time period the rates would be in effect. We must note, however, that if we had not used an average based upon when the rates would be in effect in that case we would have not had any data available to use to determine an average. In this case, however, we have both some historical data and projected data. Considering the fact that this is a working capital requirement and is, therefore, a rate base item, we feel that it is more consistent to use the Staff's recommendation as this corresponds to the rate base determined in this case. We are of the opinion that this decision is consistent with our determination of other aspects of working capital components.

**Deferred EFC Balance:**

Consistent with our finding in *Cincinnati Gas & Electric, supra*, we find that no action should be taken in this case with respect to the deferred EFC balance. As we have previously stated, we intend to consider this point in a generic proceeding.

**Working Capital Summary:**

The company objects to the 1/4 operating tax offset to the cash component of working capital. The Commission has used such an offset in the calculation of working capital for several years. The applicant has presented no justification for deviating from this standard practice. The applicant's objection on this point is overruled.

The following schedule presents in summary form the Commission's determination of the allowance for working capital to be included in rate base for purposes of these proceedings. These figures take into account revisions necessary to reflect the disposition of those other issues, such as allocations, which affect the allowance.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Jurisdictional Working Capital Allowances****(000's Omitted)****Cash Element**

(% of Adjusted Operation and Maintenance Expense, excluding Fuel and Purchased Power) .....	\$ 30,635
Fuel Expense Lag .....	5,966
Materials and Supplies .....	22,376
Fuel Inventory .....	64,317
Deferred Nuclear Fuel .....	4,737
Deferred Quarto Coal Expense .....	7,594
<b>Tax Offset</b>	
(% of Adjusted Taxes, excluding FICA and deferred FIT) .....	26,903
Customer Deposits .....	1,090
Jurisdictional Working Capital Allowance .....	\$107,632

**AFUDC:**

Determining the complete cost of a capital project requires that various overhead expense items be allocated to the capital account. The actual costs of construction, such as bricks, lumber and wages, are obviously added to the cost of the project directly, however, other costs, such as interest during construction, will also be included. This practice is obviously not limited to the regulated sector of industry. Capitalizing interest as part of the cost of construction is a common practice in most business enterprises. The peculiarity of the regulated sector, however, is that while all businesses, regulated and non-regulated, capitalize actual interest charges incurred on debt capital, the regulated sector of industry has a common practice of "imputing" interest on equity funds. This imputed interest is also capitalized by these companies and amortized over the life of the particular project. The term interest is a misnomer and the element capitalized is commonly re-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

ferred to as Allowance for Funds Used During Construction (AFUDC).

As testified to by both Mr. Chopp (CEI Ex. 20) and Mr. Hanna (Staff Ex. 10), the practice of capitalizing AFUDC in the regulated environment is an important practice to allow utilities, especially electric utilities, to recover capital costs incurred in financing construction. It is apparent that the construction period for most utility property is unusually long when compared to most enterprises and that, as a result, investor supplied capital remains unproductive for a considerable period of time. In addition, a statutory duty is placed upon the utility to serve its customers which prevents the utility from delaying these construction projects until a financially convenient time. The practice of capitalizing AFUDC provides the company with a source of funds to meet the costs of construction obligations and to provide the investor with an adequate return on investment.

The vast majority of electric utilities capitalize AFUDC for accounting and ratemaking purposes. This practice affords them the opportunity to eventually recover these costs through future revenues. In the case where the interest capitalized during the construction period actually is paid on funds borrowed to finance construction, the IRS permits the taxpayer to elect to capitalize this interest for tax purposes, despite the fact that this interest is currently deductible. Nevertheless, the majority of utility companies take the interest expense as currently deductible. This interest expense, which supports construction, therefore provides a tax benefit to current rate payers rather than to future rate payers who will be charged for the construction itself. In other words, the result of this treatment is lower rates to current rate payers because of the existence of the construction program and higher rates to future customers who are paying, through depreciation

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

charges, for the construction program without the corresponding tax benefits associated with the interest charged to the debt funding a portion of the programs. The point at issue is how to properly allocate the tax benefit associated with the debt used to fund CWIP between current and future rate payers.

The company computes its gross AFUDC rate in accordance with directives put out by the Federal Energy Regulatory Commission (18 Code of Federal Regulations, Part 101, Electric Plant Instructions, Paragraph 17, pp. 352-353; *See* CEI Ex. 20, Appendix I). The FERC Order 561 provides that this rule is to be utilized to establish uniform maximum rates for AFUDC (FERC Docket No. 75-27, Order 561, February 2, 1977). Mr. Chopp explained that the formula is in two parts:  $A_1$  = gross allowance for borrowed funds used during construction rate and  $A_2$  = allowance for other funds used during construction rate. Mr. Chopp testified that the two components were reported separately but could be combined for purposes of discussion into one total AFUDC rate from a FERC Order No. 561 worksheet (CEI Ex. 20, pp. 6-8). This rate does not take into consideration the impact of the federal income tax deduction for interest expense associated with construction projects.

Mr. Chopp also testified that the company computes a net-of-tax AFUDC rate pursuant to FERC Account 409 and the instructions that accompany that account (CEI Ex. 20, p. 10). The net-of-tax calculation is designed to account for the consequences of the tax effect of the interest for CWIP.

The real issue presented to us at this time is not in the computation of the gross AFUDC rate, but in the calculation of the net AFUDC rate and how the two components relate. In determining a net AFUDC rate the company is attempting to allocate the beneficial income tax deduction

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

associated with the debt component of CWIP between current and future ratepayers. The net AFUDC rate is the method used by the company to do this. In essence the company gives future rate payers their share of the tax benefit by capitalizing a lower AFUDC rate. This could also have been accomplished by a deferred tax account with a deduction to rate base. Both methods accomplish the same end result. The future ratepayer pays less in rates because future depreciation is less and the rate base upon which the company earns a return is smaller.

The controversy in this case arises because the company uses a net-of-tax factor *other than* the complement of the federal income tax rate in computing net AFUDC (CEI Ex. 20, p. 15). The company contends that this is proper because the determination of the FERC CWIP interest expense used in determining gross AFUDC is different than the determination of the FERC prescribed interest deduction of tax benefit used in determining net AFUDC (CEI Ex. 20, p. 15). Needless to say the Staff and Office of Consumers' Counsel disagree with this contention.

At this point it is important to point out that the methodology utilized by this Commission for determining the interest expense to be used in the calculation of federal income taxes for rate making purposes allocates *none* of the interest deduction related to the company's construction program to reduce current tax expense (OCC Ex. 2, p. 44-45). The imputed interest methodology assumes full normalization of the interest component of AFUDC. None of the tax benefits associated with construction programs are included in the calculation of federal income tax expense. The Commission assumes that these benefits have been passed on to future customers by the use of a net AFUDC component by the company. As Mr. Effron, testifying for OCC, points out, if these

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

benefits are not passed on to future customers it would be appropriate to make an adjustment to the calculation of federal income tax in this case (OCC Ex. 2A).

The issue that this Commission must decide is whether or not CEI can use one method to allocate the interest that it will earn as part of AFUDC and another method to allocate the tax benefits associated with that interest. We must find that it cannot. The method that the company employs to compute a tax benefit for the interest allocated to its construction program is inconsistent with the method that the company uses to capitalize the allowance for borrowed funds during construction. As we stated above, the imputed interest computation utilized by this Commission assumes that all of the tax benefits associated with the company's construction program are passed on to future customers. The method employed by the company to calculate net AFUDC is improper because it utilizes a net of tax factor greater than the complement of the tax rate. Thus, not all of the tax benefit associated with the company's construction programs is properly passed on to future customers. This practice is in conflict with the method used by the Commission to allocate interest which assumes all of the tax benefit is allocated to future customers. As a result the current expense for federal income tax is overstated.

The company defends this practice by pointing out that this Commission has approved such a practice in the past. In addition the company contends that it has complied with the specific directives of FERC Account 409 in computing its net of tax AFUDC rate. The company points to the testimony of Staff witness Hanna that CEI has complied with the specific language included in the Special Instructions to Account 409 (Staff Ex. 10, p. 16). However, in making these assertions, the company does not direct its attention to the issue itself. The issue is

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

whether the tax benefit associated with the interest component of AFUDC should be properly allocated to future rate payers who will bear the cost of the construction projects that gave rise to the interest expense in the first place. As OCC points out, the company's method of accruing AFUDC is a "hybrid" approach; it is neither a true gross allowance nor a true net of tax allowance. Through the use of a net of tax factor in excess of .54 the company denies to its ratepayers, either future or present, a portion of the tax deduction applicable to interest expense capitalized. We must agree with the Staff and OCC that an adjustment should be made.

There are two specific proposals on this point. Staff witness Hanna, elaborating on the testimony of Staff witness Montgomery, testified that a reduction should be made from rate base (Staff Ex. 10, p. 8). OCC witness Effron testified that the Commission should adjust current income tax expense (OCC Ex. 2A). On brief the Office of Consumers' Counsel stated that either approach would be acceptable (OCC Initial brief, p. 15). Although at first blush these positions seem inconsistent, a careful review of the issue shows that they are indeed consistent. As we stated previously the issue to be determined is whether the company has properly allocated the interest tax benefit associated with construction projects to ratepayers. If the current ratepayer was to benefit, the adjustment should be made to the federal income tax expense in this case. If the future ratepayer were to benefit, the adjustment should be made to remove the overcharge in plant value resulting from the understatement of the tax benefits assigned to interest during construction. Given the fact that our method of calculating federal income tax expense allocates none of the interest deduction related to the company's construction program to reduce current tax expense we are of the opinion that the appropriate adjustment would

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

be to reduce rate base according to Mr. Hanna's recommendation.

We find therefore that the applicant's rate base should be reduced by the jurisdictional amount of the total adjustment of \$5,229,000. This amount, which represents the necessary adjustment through March 31, 1981 (Staff Ex. 10, pp. 17-18), shall be revised in applicant's next rate case to include a further adjustment for the period subsequent to March 31, 1981, as appropriate. The disposal of this rate base adjustment shall be through credits to the appropriate plant accounts and/or to certain related construction projects which are still in progress, with the applicable portions of the aforesaid adjustment. The company is directed to make these correcting entries as soon as administratively possible but within a period not to exceed five years. These entries shall be subject to the Commission Staff's review and verification. The company is further directed to use the complement of the tax rate to determine the net AFUDC from now on.

**Accumulated Deferred Taxes and Tax Credits:**

The Staff reduced the rate base by the jurisdictional portions of certain accelerated amortization, liberalized depreciation, and deferred taxes at the date certain (Staff Report, p. 33). These deferred taxes represent funds provided to the utility from sources other than investors. The removal of these funds from rate base insures that investors do not earn a return on assets financed from other than investor supplied funds. The applicant objected to this deduction but did not vigorously pursue this issue. Mr. Montgomery testified that the Staff's position on this issue is reasonable and in conformity with past Commission decisions (Staff Ex. 5, p. 17). We find the Staff's position should be adopted.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Other Considerations:**

OCC contends that a deduction should be made from rate base to account for deferred nuclear fuel disposal costs which the company is accruing. The Staff recommends that the company be allowed to earn a return on these funds because of inflationary factors, stating that the company will not have sufficient funds to meet this anticipated cost if such a return is not allowed. We are of the opinion that no deduction is called for.

The applicant has objected to the Staff's failure to include AFUDC in the applicant's deferred nuclear fuel balance. A review of the record indicates that nothing has been presented to alter the decision made on this point in the last CEI rate case. The Staff's position on this point is accepted. This figure should be included net of tax as testified to by Mr. Montgomery (Staff Ex. 5, p. 17).

**Rate Base Summary**

In light of the foregoing discussion, the Commission finds the jurisdictional rate base as of the date certain to be as set forth on the following table.

**Jurisdictional Rate Base Summary**

(000's Omitted)

Plant in Service .....	\$2,414,863
Depreciation Reserve .....	(555,716)
Net Plant in Service .....	\$1,859,147
CWIP .....	40,596
Working Capital .....	107,632
Other Items .....	(106,848)
Rate Base .....	\$1,900,527

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****OPERATING INCOME**

The applicant in this case has submitted two test year proposals pursuant to Commission Entry of March 9, 1981. The figures on the test year ending September 30, 1981 operating income provided by the company reflect three months of actual data and nine months of forecasted data. The figures on the 1982 test year are based upon fully forecasted data. The Staff recommended adjustments to both test years, but did not make a recommendation as to which test year should be utilized. Consumers' Counsel offered further adjustments to the test year ending September 30, 1981 and recommended that the 1982 test year be rejected.

Discussion and implementation of certain recommendations of the parties are discussed below. The Commission adopts the Staff's recommendations on those issues not specifically addressed.

**Fully Projected Test Year:**

The initial question that must be determined with respect to revenues and expenses is the selection of the appropriate test year. On January 30, 1981 the company notified the Commission of its intent to file an application for an increase in rates and of its intent to use in that application a future test year. By Entry dated March 4, 1981 the Commission reserved ruling on the use of a future test year but allowed the company to file a test year on this basis as well as a test year on the basis of six months actual and six months projected data.

Any discussion on the selection of an appropriate test year must begin with Section 4909.15(C), Revised Code, which reads as follows:

- (C) The test period, unless otherwise ordered by the public utilities commission, shall be the twelve-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

month period beginning six months prior to the date the application is filed and ending six months subsequent to that date. The revenues and expenses of the utility shall be determined during the test period. The date certain shall be not later than the date of filing.

As we have stated previously, this statute grants to the Commission discretion in the selection of a date certain and test period for ratemaking purposes. The only limitation placed upon the exercise of this discretion is that the date certain cannot be later than the filing of the application. In the selection of an appropriate test period, however, the statute places no such limitation on the Commission. On the contrary, the phrase "unless otherwise ordered" clearly establishes statutory authority for this Commission to select a test year other than the one specifically mentioned in the statute. The fact that we have not chosen to do so is no reflection of either the legality or the desirability of such a course of action.

Having concluded that the use of a future test year is a viable, legal alternative, we must next address the general policy considerations of such a choice before we can speak to the use of such a model in the instant case. The following discussion is not meant to be an exhaustive treatise on the subject but rather to indicate some of the matters which we have taken into consideration.

We have, on previous occasions, set forth discussions concerning the pros and cons of the selection of a future test year for ratemaking proceedings. Arguments in favor of its use include the presence of high and continuing inflation in the U.S. economy, the expectation that the use of projected data will reduce rate case filings, and the presence of continued earnings erosion in the utility industry. On the other hand, the most obvious criticism of its use is the potential for inaccuracies in the projected data.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

The most important consideration, in our opinion, in the selection of an appropriate test year is the determination of what data represents the most realistic appraisal of what is required to afford the applicant a *reasonable* earnings opportunity for the period in which the rates established by this proceeding will be in effect. The determination of this issue has generated considerable debate and much confusion in this case, as well as in other cases decided by this Commission, since the concept was first introduced in the applicant's last rate case. In performing the regulatory function we must be mindful of what it is we are attempting to achieve. Perhaps it is the use of the term "test year", which focuses the attention on how the utility *did* perform instead of how it *will* perform, which caused much of the confusion. Utilities are subject to regulation as a substitute for the economic controls of competition to assure fair pricing and adequate service to their customers. The twelve month operating period that we select is to be used as a measure to evaluate the adequacy of the rates being proposed by the applicant. In evaluating these rates we must select that measure which is the most realistic appraisal of what is necessary to grant CEI a reasonable earnings opportunity.

The Office of Consumers' Counsel and the City of Cleveland strongly oppose the use of a forecasted operating period as a measure to evaluate the reasonableness of the rates proposed by CEI in this case. Many of the issues raised by these parties, however, miss the point entirely. OCC witness Madan testified at length on the problems associated with the implementation of a forecasted operating period (OCC Ex. 3). Mr. Madan testified that in his opinion there was a very fine line between a rate case presentation involving forecasted data and a budget approval process (OCC Ex. 3, p. 10). In addition Mr. Madan expressed fears that a utility would "backlog"

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

certain projects for which it felt it did not have adequate financial resources and request consideration of these items in a rate proceeding without intending to actually implement such projects. On a similar note, Mr. Madan expressed concern that amounts approved in a rate proceeding would not actually be expended in a manner consistent with the company's proposal. Finally, the witness testified that the increased complexity of such proceedings would hamper the regulatory process in such a manner as to place an undue burden on this Commission and its Staff.

We are of the opinion that these criticisms do not address the real issue to be determined. The fact that there are possible problems associated with the use of forecasted data does not address the reasonableness of that data as a measure of what rates a utility should be allowed to place into effect. Focusing one's attention on the problems experienced by other jurisdictions does not address what is spread on the record before us. It is true that the experiences of other jurisdictions may be extremely helpful in assisting this Commission in avoiding some problem areas and in designing specific programs, but it does not address the real issue of the reasonableness of the rates proposed by the applicant.

We believe that it is appropriate to use the projected data in *this* case for *this* company. The record clearly indicates that CEI, as a major electric utility, is particularly susceptible to inflation and to high interest rates. The record also shows that earnings erosion is a particular problem for CEI. Furthermore, the projected period proposed by CEI in this case bears a reasonable relationship to the period over which the rates set in this case will be collected. Although we do not here infer that the projected test year is the answer to all problems in all cases, we believe it to be appropriate in the instant matter. We feel that these

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

conditions outweigh the necessity of specifically matching date certain and the operating period in this case.

The City of Cleveland and OCC on brief challenge the propriety of the December update made by the applicant as a revision to its forecasted data. In the instant case the applicant filed revised figures for the 1982 operating period on December 18, 1981 (CEI Ex. 1E). Both OCC and the City of Cleveland object strenuously to the consideration of this material filed at such a late date. However, a careful review of the record in this matter reveals that neither party requested additional time to review this material. It should also be noted that although this material was filed on December 18, 1981, the hearing in this matter did not start until January 4, 1982 and Mr. Zitzman, the company witness sponsoring the forecasted data, did not take the stand until January 11, 1982. Thus, although the time period might not have been as long as we would like, we feel it was adequate to allow sufficient preparation. It should also be noted that the company did not complete its case until January 14, 1982 which would have been the first date at which any other party would have had to present its case.

Based upon the above discussion we find that the use of projected data is appropriate in this case. We still, however, must analyze some of the individual components of that data to determine its reasonableness for ratemaking purposes.

**Revenues:**

A great deal of information was spread upon the record concerning the method that the company used to forecast revenues. Mr. Zitzman, testifying on behalf of the company, stated that the sales figures in the company forecasts are based upon an aggregation of components (CEI Ex. 11 and 11A). Sales to each of the various classes

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

of service are forecasted separately and combined to produce a forecast of total sales. There are a number of methods utilized by the company to develop a sales forecast for the various components. Such techniques include customer interviews, econometric models, end use models, logistic curves, time series analysis and regression analysis. Deborah A. Hensel, testifying on behalf of the Staff, reviewed the company techniques in preparation for this hearing. Ms. Hensel testified that the Staff's investigation included procedures to evaluate both the assumptions used by management and the preparation and presentation of that financial forecast (Staff Ex. 4). Ms. Hensel testified that the Staff made a review of this forecasted data in accordance with the applicable guidelines for a review of financial forecasting as established by the American Institute of Certified Public Accountants and found the forecast made by CEI in this case to be in conformity with those guidelines (Staff Ex. 4, p. 28).

One of the major areas of controversy regarding the use of forecasted data in this proceeding centers around the revision filed by the company on December 18, 1981. Both OCC and the City of Cleveland contend that this information should not be considered because of the date of filing. Although we have touched on this topic previously we feel some additional comments are in order.

Witness Hensel testified that the Staff reviewed the updates presented with respect to revenues although they did not make a comparison of all of the variables and assumptions used by management in the revisions (Staff Ex. 4, p. 6). She testified that one of the major differences between the revised 1982 forecast and the original filing can be seen in the updated forecast of sales. The variables used in the residential end use model and in the commercial econometric model have been updated to reflect the most current data available. Another variable updated to

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

reflect more current data was the forecast of the Federal Reserve Board index which is also a variable used in the econometric model. The revised forecast for the miscellaneous sales such as sales for resale, street lighting, traffic lighting, etc., would also reflect the use of the most current data.

The major difference in the sales forecasts, however, can be seen in the forecast of the industrial class sales. The forecast of the specifics in the industrial class have been revised to reflect the updated forecast of the future operations and requirements of these 17 firms. The revised sales forecast for this group reflects two changes: (1) updating to the most current data available, and (2) the addition of a variable which has been added to the industrial econometric model to account for the depressed auto industry.

As can be seen from the exhibits filed in relation to the revised 1982 forecast, the sales component, specifically industrial sales, substantially increases the revenue deficiency of the company. OCC and the City of Cleveland object to this information because they contend that sufficient opportunity has not been afforded to review it. Upon review of the record, however, we find that the Staff has sufficiently reviewed the information to determine that it reasonably reflects what may be expected as far as CEI's revenues in 1982. As Staff witness Hensel has testified, the Staff *did* review the company's forecasting techniques. What the company has done in its 1982 revisions is to update information. Although the updated information included the addition of another variable, we cannot conclude that this is a fatal modification. We, therefore, find the company's revenue proposal to be reasonable.

The applicant contends that base revenues for Period II should be annualized to reflect the tariff rates estab-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

lished in Case No. 81-1096-EL-COI as well as Case No. 80-376-EL-AIR. The Staff agrees with this proposition. We find, therefore that base revenues should be annualized to reflect the revenues that would have been received by the company if the rates established in Case No. 81-1096-EL-COI had been in effect for a full year.

In addition, it should be noted that the company has used projected EFC rates to determine an appropriate adjusted fuel cost and fuel revenue level for the upcoming operating period. Since this case was concluded the Commission has established a new EFC component in *Cleveland Electric Illuminating Company*, Case No. 81-309-EL-EFC, Opinion and Order, February 24, 1982. The Staff should review the projected EFC rates in light of the findings made to compute the new component established in the most recent fuel case and adjust the projected fuel revenue and expense components accordingly.

**Labor Expense Adjustment:**

The Staff considered the labor expense and number of employees included in Period II to be overstated (Staff Report p. 26). The company objects (CEI objections 6 and 12). Staff witness Hensel testified that the company has developed a trend to overbudget for the level of employees and found that a comparison of budget to actual results for recent years, including 1981, supports this conclusion (Staff Ex. 4, p. 3). Witness Hensel testified that the budget, when prepared, is based upon the applicant's needs for a future time frames; however, the budget does not grant authorization to hire these new employees. Based upon this analysis, she concluded the budget will usually exceed the actual level attained until the budget process includes authorization to hire.

Mr. Zitzman, testifying on behalf of the company, agreed with the Staff that it was appropriate to adjust

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

the labor expense forecast made by the company, but did not agree with the magnitude of the adjustment (CEI Ex. 11A, p. 19). The company did file an adjustment to labor expense in the updated filings of December 18, 1981 (CEI Ex. 1D, p. 17D). Mr. Zitzman testified that the company used a manhour per customer ratio method similar to the Staff's; however, this method was recently revised as part of the company's budgeting process to yield more accurate results. Mr. Zitzman also testified that the company's proposal used more recent data than the adjustment reflected in the Staff Report.

Based upon a review of the record, we find the company's proposed adjustment to be reasonable in this case. Both the company and the Staff agree that an adjustment is appropriate. We find that the company's proposal utilizes the most recent data in developing a specific adjustment while utilizing a technique similar to the one employed by the Staff.

**Other-than-Labor Expense:**

Based upon the Staff's review of the other-than-labor (OTL) expense, the Staff made an adjustment to eliminate an other-than-labor contingency adjustment included in the 1982 forecast (Staff Report p. 26). The company objected (CEI objection 12). The company presented a revision of the OTL calculation in the testimony of Mr. Zitzman (CEI Ex. 11A, p. 16, CEI Ex. 1D, p. 17D).

Staff witness Hensel testified that based on the Staff's review of other-than-labor expense, the Staff made an adjustment to eliminate an OTL contingency adjustment included in the 1982 forecast. This contingency adjustment was made to recognize unforeseeable costs to be incurred during 1982 (Staff Ex. 4, p. 4). Witness Hensel stated that the contingency adjustment cannot be separated as to individual items and that the applicant has

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

determined only that the other-than-labor expenses were underbudgeted based on historical trends and included an amount to cover part of this deficiency. The Staff would agree that the level of other-than-labor expenses is probably understated. However, this contingency adjustment should be eliminated.

Mr. Zitzman stated that the contingency adjustment was to recognize unforeseeable costs to be incurred by the company during calendar year 1982 and that it had been eliminated in the updated figures (CEI Ex. 11A, p. 18). Based upon the above discussion we find that the revised figures presented by the company are appropriate for establishing the OTL expense.

**Depreciation Expense:**

The Staff accepted the applicant's depreciation expense for Period II (Staff Rpt. p. 24). This expense, however, did not recognize the new depreciation accrual rates authorized in Case No. 81-839-EL-AAM. The applicant proposed an adjustment of \$2,097,000 to Period II depreciation expense to account for the revision in accrual rates (CEI Ex. 1E, Schedule C-3.3). Mr. Fox testified that the latest known accrual rates should be used in calculating depreciation expense for Period II (Tr. XIV, p. 64-66). Company witness Szwed testified that the \$2,097,000 adjustment is necessary to properly reflect the impact of the new accrual rates (CEI Ex. 10A, pp. 10 and Tr. III 128-130). We find the adjustment to be appropriate.

**Davis-Besse Refueling Outage:**

Both the applicant and the Staff made adjustments to test year expenses to reflect the scheduled refueling outage from February 26 to May 21, 1982 (Staff Report, p. 7; Tr. VII, p. 139). OCC and the City objected (OCC Obj.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

9, City Obj. 74). OCC witness Effron supported OCC's position that this adjustment should not be reflected in the calculation of operating expenses (OCC Ex. 2, pp. 38-40). Staff witness Montgomery supported the Staff's position that this adjustment is necessary and appropriate for ratemaking purposes. However, Mr. Montgomery adjusted the twelve month refueling cycle to fourteen months because of his analysis of the refueling outages scheduled for 1984 and 1985 (Staff Ex. 5, p. 31).

Mr. Montgomery testified that there is approximately a twelve month lag between the 1982 and the 1983 refueling outage as well as between the 1983 and 1984 outages. However, there is a scheduled lag of approximately 18 months between the 1984 and 1985 refueling outages. After 1985, these outages are expected to occur about every 14 to 15 months. The average time lag between scheduled outages in 1982, 1983, 1984, and 1985 is 14 months. As the average scheduled lag is 14 months, Mr. Montgomery recommended that the costs of refueling outages should be normalized over a 14 month period, not a 12 month period as requested by the applicant (Staff Ex. 5, p. 31). We find that the Staff's proposal should be accepted.

**New Excise Tax Changes:**

By Entry of November 25, 1981 in Case No. 81-1408-AU-UNC, the Commission permitted utilities to file tariffs to provide for a surcharge of .71% to recover increases in excise taxes on gross receipts as a result of new tax laws passed in November 1981. That Entry also provided that companies could seek alternative treatment by separate filing.

On December 15, The Cleveland Electric Illuminating Company filed both an application in Case No. 81-1408-AU-UNC seeking to implement the .71% surcharge, and an application seeking alternative treatment, which was

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

docketed as Case No. 81-1566-HT-UNC. In this latter application, CEI requested that the Commission approve a surcharge resulting from the repeal of the Charter City Credit, in addition to the .71% surcharge. By Entry of December 23, 1981, the Commission approved The Cleveland Electric Illuminating Company's application in Case No. 81-1408-AU-UNC, which permitted the company to implement the .71% surcharge. We have consolidated Case No. 81-1565-HT-UNC with this rate case so that we may deal with the issue of the Charter City Credit surcharge.

Section 4909.161 of the Revised Code indicates the intent of the General Assembly that utilities be permitted to fully recover increases in excise taxes. The Staff recommends that the repeal of the Charter City Credit be reflected by an adjustment to base rates approved in the rate case (Staff Ex. 5, p. 8). The Commission agrees with that recommendation. Therefore, CEI's request to recover the increase in excise taxes due to the repeal of the Charter City Credit is granted, but as an adjustment to base rates, and not as an additional surcharge. This finding is consistent with our finding in *Cleveland Electric Illuminating Company*, Case No. 81-41-RT-AIR, Opinion and Order, January 13, 1982.

**Nuclear Fuel Disposal Costs:**

The only difference in the approaches taken by the applicant and the Staff in the determination of the nuclear fuel disposal cost factor used in this case is that the Staff does not recognize transportation costs to be incurred in the shipment of spent fuel from the plant to a temporary Away From Reactor (AFR) storage facility. The Staff excluded these costs on the basis of the fact that the location of these storage facilities is currently unknown (Staff

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Ex. 5, p. 5). We must agree that it would be inappropriate to speculate on the amount of these costs.

OCC opposes the increase in the allowed nuclear fuel disposal costs. OCC claims that these costs are largely unknown and should remain at current levels. We must disagree. It is known that these costs are increasing and these charges should be recognized. We therefore adopt the Staff position.

**Gross Receipts Tax:**

The applicant objects to the Staff's exclusion of the 1% gross receipts tax, claiming that the company should be guaranteed 100% recovery of such an expense item (CEI Objection 19). The company claims that such an expenditure did occur and that it should be recovered.

In determining whether the tax in question should be included in the company's expenses, the question is not whether the tax was in fact paid, but whether the tax represents a reasonable estimate of what the company will incur as expenses during the period these rates will be in effect. Clearly, it does not. The company's objection should be overruled.

**Uncollectibles:**

The applicant requested an expense adjustment for uncollectibles (Schedule C-3 11; CEI Ex. 5, p. 15). The Staff adjusted uncollectibles to reflect the Staff's adjustments to operating revenue (Staff Report, p. 9). The correct ratio for Period II is .00269 (CEI Ex. 5A, p. 3).

**Terminated Nuclear Units:**

Applicant has requested an allowance for ratemaking purposes for the amortization of the costs incurred with respect to four cancelled nuclear units. This subject was

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

fully discussed in *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR, Opinion and Order, July 10, 1980, in which the Commission approved such an amortization. The Commission approved the same amortization in applicant's subsequent rate case, *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR, *supra*, and approved a similar amortization in *Ohio Edison*, Case No. 80-141-EL-AIR, Opinion and Order, April 9, 1981. The Commission would approve the amortization again if it were not constrained by the decision of the Supreme Court of Ohio in *OCC v. Public Utilities Commission*, 67 Ohio St. 2d 153 (1981). This case clearly holds that this expense is, as a matter of law in Ohio, not includable as an operating expense for ratemaking purposes. The Commission must, therefore, deny applicant's request. In *Cleveland Electric Illuminating Company*, Case No. 81-1096-EL-COI, Opinion and Order, October 21, 1981, this Commission, while it reduced applicant's electric rates by the annualized amount of the amortization which had been allowed in Case No. 80-376-EL-AIR, indicated that it would determine the appropriate disposition of the remaining unamortized balance in this proceeding. The Commission believes that the return allowed in this proceeding provides revenues sufficient to provide for amortization of that balance over a reasonable period of time. Accordingly, although we cannot allow an amortization allowance for ratemaking purposes, for book purposes the applicant is authorized to amortize the balances assignable to the terminated nuclear units over an appropriate period of time, not to exceed 15 years.

**Economic Recovery Tax Act of 1981:**

The Economic Recovery Act of 1981 (Act) became law on August 13, 1981. Under the Act, the asset depreciation range (ADR) system of tax depreciation contained in

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

the old law was replaced with a new system called accelerated cost recovery system (ACRS). Under ACRS, the cost of an asset is recovered over a predetermined period, generally shorter than the useful life of the asset and often shorter than the period used under the old ADR system.

The Commission has in recent cases authorized the normalization of the tax benefits of the ACRS system of depreciation on property placed in service after December 31, 1980. (See, e.g., *Monongahela Power Company*, Case No. 80-760-EL-AIR, Opinion and Order, September 2, 1981, at p. 5; *Dayton Power and Light Company*, Case No. 80-1087-GA-AIR, Opinion and Order, September 30, 1981, at pp. 5-6; and *Cleveland Electric Illuminating Co.*, Case Nos. 81-41-HT-AIR and 81-1566-HT-UNC, Opinion and Order, January 13, 1982, at pp. 12-13). Based on the evidence of record, we see no reason why the applicant in these cases should not be authorized to normalize the tax benefits from the new ACRS system of depreciation here. Therefore, the Commission finds that the normalization requirements of ERTA have been met and the applicant is authorized to normalize the tax benefits of ACRS depreciation on its recovery property placed in service after December 31, 1980.

The City objects to the sale of ERTA tax benefits by CEI. As pointed out by the company this transaction took place after date certain. It should be noted that this sale also took place prior to Period II which we have adopted in this case. We find, therefore, that there are no rate case issues to be changed in connection with the sale.

**Ohio Coal Tax:**

The data submitted by the applicant for Period II in this case included an allowance for an Ohio Coal Tax. No such tax has as yet been placed into effect. The Staff has

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

adjusted Period II to remove the costs of such a tax and we find that adjustment to be proper.

**Advertising:**

The Staff made an adjustment to exclude a portion of the test year advertising expense. We find the Staff's recommendation on this point for Period II to be appropriate and we adopt its recommendation. This recommendation is based upon the Staff's analysis of Period I advertising costs. Although the advertisements for 1982 have not yet been shown, we find that this is a reasonable method to approximate an appropriate amount.

**Antitrust Expense:**

The City of Cleveland objects to the inclusion in expenses of amounts expended in connection with the civil antitrust action brought by the City against the company. The City claims that these expenses are not recurring and that they are not related to the cost of rendering service. We must disagree with the City and find that these are proper expense items for which no adjustment is needed. It is evident that CEI is continuously involved in a wide variety of civil legal actions. We are of the opinion that legal fees such as this are proper and necessary business expenses for ratemaking purposes.

**Other Items:**

The applicant proposes that PUCO and OCC maintenance expense, FICA and Sales taxes be updated to the most recent known rates. We are of the opinion that these adjustments are proper and should be implemented. PUCO and OCC taxes should also be reclassified from expense items to tax items.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

In addition the Staff has eliminated social and service club dues from operating expenses. We are of the opinion that such an adjustment is proper.

The Staff originally amortized rate case expense over two years; at the hearing, witness Hensel recommended a change to a one year amortization (Staff Ex. 4). We find a one year amortization to be appropriate.

**Operating Revenues and Expenses Summary:**

Consistent with the foregoing discussion, the Commission finds the applicant's jurisdictional adjusted revenues and expenses for Period II to be as follows:

(000's Omitted)

Operating Revenues .....	\$1,059,315
Operating Expenses:	
Operation and Maintenance .....	622,403
Depreciation .....	85,902
Taxes Other Than Income Tax .....	102,289
Federal Income Taxes .....	71,241
Total Operating Expenses .....	\$ 881,835
Net Operating Income .....	\$ 177,480

**PROPOSED INCREASE**

A comparison of jurisdictional Period II operating revenues of \$1,059,315,000 with allowable jurisdictional expenses of \$881,935,000 indicates that under the applicant's existing permanent rates, applicant would realize income available for fixed charges of \$177,480,000. Applying this dollar return to the jurisdictional rate base of \$1,900,527,000 results in a rate of return of 9.34 percent. This rate of return is below that recommended as reasonable by any of the expert witnesses testifying on this

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

subject, and the Commission therefore finds that the applicant's existing permanent rates are insufficient to provide the applicant reasonable compensation and return for the electric service it renders to customers affected by this application. Rate relief is clearly required.

Under the rates proposed by the applicant, additional gross annual revenues of \$134,352,000 would have been realized, based on Period II operations as analyzed herein. On a *pro forma* basis, which assumes necessary expense adjustments calculated in a manner consistent with the Commission's findings, this increase in gross revenues would have yielded an increase in net operating income of \$69,496,000, resulting in income available for fixed charges of \$246,976,000. Applying this dollar return to the jurisdictional rate base results in a rate of return of 13.00 percent. The Commission must examine the various rate of return proposals submitted in this proceeding in order to determine if this is a fair rate of return for purposes of establishing just and reasonable rates.

**RATE OF RETURN**

Four witnesses gave testimony concerning the determination of a fair and reasonable rate of return for The Cleveland Electric Illuminating Company. Mr. Francis E. Jeffries and Mr. Edgar H. Maugans presented testimony on behalf of the company. Mr. Randy G. Farrar presented testimony on behalf of the Staff of the Commission. Dr. Matityahu Marcus presented rate of return testimony for the Office of Consumers' Counsel. In addition to these four gentlemen, Mr. Ralph E. Miller presented testimony on the related subject of flotation costs on behalf of the Office of Consumers' Counsel.

Mr. Jeffries recommended that a 19% figure be used for return on common equity (CEI Ex. 8A). He combined this recommendation with the capitalization percentages

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

and the embedded costs of debt and preferred stock of the company, as of October 31, 1981, to arrive at an overall recommended rate of return of 12.92% (CEI Ex. 8A, Exhibit 8 FEJ-17). Mr. Maugans recommended a return on equity component of 19-20% (CEI Ex. 4A). Mr. Maugans also combined this recommendation with the embedded costs and capital structure of the company to arrive at an overall rate of return recommendation of 12.92% - 13.28% (CEI Ex. 4A, p. 25). It should be noted, however, that Mr. Maugans expressly advocated the use of the most current capital structure of the company to derive a rate of return. Dr. Marcus recommended a rate of return on common equity of 15.50% (OCC Ex. 1A). He also combined this recommendation with the capital structure of the CEI for October 31, 1981 to derive an overall recommendation of 11.68% (OCC Ex. 1A, Schedule MM-21). Mr. Farrar recommended a cost of equity component of 17.02- 18.13% (Staff Ex. 3A). Mr. Farrar combined this recommendation with a capital structure as of January 19, 1982 to derive an overall cost of capital recommendation of 12.14 - 12.56% (Staff Ex. 3A).

**Capital Structure:**

As stated above, three of the witnesses testifying on rate of return, Mr. Maugans, Mr. Jeffries and Dr. Marcus, used the capital structure of the CEI as of October 31, 1981. Mr. Farrar was the only witness to specify a structure as of a different date, namely, January 19, 1982. Mr. Farrar's purpose in updating his capital structure was to reflect a large common stock offering by the company as of January 19, 1982 (Tr. 17, p. 4). Mr. Farrar testified that this approach is consistent with the Staff's effort to use the most recent data in determining a current cost of capital.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Although the other witnesses did not update their figures in the same manner as did Mr. Farrar, none of the witnesses stated opposition to such a procedure. In fact, Mr. Maugans recommended the use of the most recent capital structure, stating that it would be appropriate to recognize the stock issued in January of 1982 (CEI Ex. 4A, p. 2). Again, although Dr. Marcus did not update his figures, he stated that he used the October 31, 1981 figure because it was "the most recent actual figure available" (OCC Ex. 1A, p. 9).

The use of the most recent data in determining an appropriate capital structure has been approved by the Commission in numerous recent decisions (*see, e.g., Cleveland Electric Illuminating Co., Case No. 80-376-EL-AIR, supra*), and we again find it appropriate to do so. The use of the most recent data best reflects the cost of capital which the company will experience during the period when the new rates will be in effect. Therefore, the common equity component is found to be \$1,063,006,247 or 37.67%, the preferred stock component is found to be \$418,221,818 or 14.83% with an embedded cost of 9.44% and the long term debt component is found to be \$1,339,103,689 or 47.48% with an embedded cost of 9.13% (Staff Exhibit 3A).

**Cost of Common Equity:***Baseline Cost of Equity*

In selecting a fair and reasonable rate of return on common equity the Commission is confronted with numerous theories and models, as well as vast amounts of relevant data. The extent of this assortment of models and information is exemplified by the record spread before the Commission in the instant proceeding. In addition to the normal presentations that are made in a major rate case,

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

the parties in this case have also placed special emphasis on the determination of flotation costs to the company. Of course, the Commission can only select one rate of return. Thus, the discussion that follows is not intended as an exhaustive treatment of the issues raised, but merely an attempt to set forth the basic underpinnings of the selection of a fair and reasonable rate of return. This does not mean that the Commission rejects other data or other techniques as unacceptable, but merely that the Commission exercises its judgment and selects that recommendation deemed to be most appropriate.

Mr. Edgar H. Maugans, Vice President Finance of the Cleveland Electric Illuminating Company, recommended a range for return on common equity of 19-20% (CEI Ex. 4A, p. 6). Mr. Maugans began his analysis with an overview of the recent financial history of CEI and the general status of the economic markets as a whole. Mr. Maugans pointed out that during the past decade the financial strength of the company has deteriorated, substantially jeopardizing its ability to effectively compete in the financial markets. In support of this proposition, Mr. Maugans testified that in 1974 the company's first mortgage bond rating was triple-A. This rating has slowly dropped over the years until July 1981, when this rating was decreased to single-A by both Standard and Poor's and Moody's (CEI Ex. 4A, p. 6). Mr. Maugans also noted that paralleling the company's credit rating reductions has been a decline in the market price-to-book value ratio of the company's common stock. As a result CEI sold a new issue of common stock below book value in 1979 and 1980. It was also expected that the sale of stock in late 1981 or early 1982 would be below book (CEI Ex. 4, p. 4). Mr. Maugans testified that as the company's bond credit rating has weakened, the investment risk perceived by the CEI equity owner has increased and the company's ability to

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

finance under different methods has been harmed in all types of economic circumstances. Mr. Maugans testified that under these circumstances fair and adequate rate relief is a necessity.

With this general overview as a basis, Mr. Maugans used two methods of analysis to determine a recommendation for return on equity; a modified Discounted Cash Flow (DCF) method and a risk premium approach. The DCF model utilized by Mr. Maugans was first presented to this Commission in *Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR, *supra*. At that time the Commission rejected the use of such a technique and relied instead on the traditional DCF method. Again we are presented with the technique and further review is in order.

The basic difference between the DCF method employed by the Staff and the method utilized in Mr. Maugans' analysis is the introduction of a future selling price by Mr. Maugans. He contends that the omission of a selling price term implies that all investors currently view the stock as fairly priced, relative to prospective dividends, and that the stock price will grow at the same rate as will dividends (CEI Ex. 4, p. 5). Mr. Maugans rejects such a contention and submits that stock price growth and dividend growth are *not* synonymous. He contends that the expected growth in the selling price of the stock can, and should, be measured independently from any growth in earnings.

In order to derive a future selling price, Mr. Maugans first computed an average holding period for CEI stock based on the average annual CEI common stock turnover rate of the last decade (CEI Ex. 4, p. 16). This computation gave the time period used as an average holding period for the stock of 5-6 years. Having established this period Mr. Maugans computed an expected price for CEI stock

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

in 1986 and 1987. In his analysis Mr. Maugans assumes that the market price-to-book ratio of CEI stock is or should be 1. As justification for such an assumption Mr. Maugans states that the DCF method "implicitly" assumes that market price will equal book value. Thus, Mr. Maugans calculated an expected future book value for CEI stock and equated this number with a future market price. In deriving this book value, Mr. Maugans assumed various earning levels, dividend payments and retention ratios for the company during the upcoming five or six years. After deriving the future market price, Mr. Maugans uses his modified DCF equation to derive a cost of common equity.

A few comments seem appropriate. First, it must be noted that the key element in the estimation of a future market price under this method is the assumption that market price will equal book value. It is interesting to note that in criticizing the Staff's use of the "b x r" method Mr. Maugans points out that the last three issues of common stock by CEI have all been below book value (CEI Ex. 4, p. 14). This point is further illustrated by the fact that CEI's stock has not traded above book value since 1977 (Staff Report, p. 46).

It must also be noted that, although Mr. Maugans submits that the future selling price of the stock can be measured independently from dividend or earnings growth, he assumes specific values of growth for each of these factors in estimating the future book value of CEI stock. In addition, for one computation he assumes a steadily decreasing pay out ratio which results in an earnings growth rate in the later years far in excess of what appears to be reasonable.

The basic assumption which Mr. Maugans claims supports the use of his DCF model is that investors do not hold common stock for indefinite periods of time. Although

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

we do not contest the validity of this assumption, we do not agree that the traditional DCF model ignores this fact in determining a rate of return. As we know, the intended holding periods of different investors vary a great deal. Some investors will hold a stock for only a few days, while others might plan to hold it indefinitely. Those investors with definite holding periods plan and hope to be able to sell the stock in the future at a price higher than what they have paid for it. This assumes, of course, that at that time there will be other investors who are willing to buy it at the price reflecting their expectations of future dividends and future terminal value beyond that point. That terminal value will depend upon other investors at that time being willing to buy the stock. The price they are willing to pay will depend upon their expectations of dividends and terminal value. So the process of evaluation of the stock is carried out by successive investors and the presence or absence of different holding periods becomes irrelevant. The total cash flow to all successive investors in a stock is the expected future dividend stream. This is the basic assumption of the traditional DCF model: that the expected future cash dividends are all that stockholders, as a whole, expect to receive from their investment. Thus, based upon this analysis and the points raised above, we must find that the use of the traditional DCF model is proper and must reject the use of the DCF model presented by Mr. Maugans.

Mr. Maugans also presented a risk premium analysis in recommending a cost of equity for CEI. The risk premium analysis is a method of quantifying the additional return required for investment in common equity over investment in debt or preferred stock. As a base measurement Mr. Maugans initially used the average yield on Moody's double-A utility bonds. Given the fact that CEI's first mortgage bond rating was lowered in July 1981, how-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

ever, he switched the base component to the yield on single-A utility bonds, which of course would be higher (CEI Ex. 4, p. 6). For the risk premium, however, Mr. Maugans developed a premium based on double-A rated bonds and applied this same premium to the single-A rated base component. It is readily apparent that the risk spread between CEI stock and single-A bonds should be less than the risk spread between CEI stock and double-A rated bonds. To use the risk premium from one type of security with the base yield of another type of security does not yield an accurate result. Mr. Maugans should have compared the risk spread between CEI stock and single-A rated bonds to the single-A bond yields.

In addition, it should be noted that in developing a risk premium on applicant's common equity, Mr. Maugans used a five year dividend growth rate which was added to an average yield on common equity to derive a total return on common equity. It is interesting to note that this analysis resulted in a return on equity of 16.51% for CEI in 1980 (CEI Ex. 4A, p. 28). Mr. Jeffries in his analysis of risk premium used a 15.50% return on common equity for the Standard and Poor's 400 Industrials for 1980 (CEI Ex. 8, Exhibit 8 FEJ-12, p. 48). A comparison of the two numbers casts serious doubts on the validity of an analysis that imputes an expected return on equity for The Cleveland Electric Illuminating Company that is higher than that associated with the Standard and Poor's 400. A return on equity of 16.51% is higher than most returns granted by this Commission. We cannot accept a recommendation based upon such an analysis.

Mr. Jeffries also presented testimony on behalf of the company for the determination of an estimated cost of common equity. Mr. Jeffries began his analysis with a review of the current financial conditions present in today's economy. He specifically considered factors of inflation,

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

business risks and financial cost and how they influence investment decisions.

Much of the preliminary discussion set forth by Mr. Jeffries centered around inflation and its effects on interest rates, earnings, monetary policy and the business community in general. It is evident that inflation impacts heavily on utility companies in rising costs for labor, fuel and other expenses. Mr. Jeffries noted, however, that the impact of inflation upon utilities is even more intense because the utility industry is capital intensive, thus the impact upon a utility company affects not only rising operating costs but also the costs associated with large construction projects, interest rates and the cost of capital. Needless to say these issues have been presented to the Commission at length by the utility companies of Ohio.

Mr. Jeffries initially recommended a return on equity of 17-18% (CEI Ex. 8, p. 53). In his supplemented testimony he updated this figure to no less than 19% (CEI Ex. 8A, pp. 1-2). In developing a rate of return recommendation, Mr. Jeffries used a comparable earnings approach, an equity-debt risk premium approach, and the DCF method.

Mr. Jeffries began his analysis of comparing returns earned by CEI to the returns earned by both regulated and non-regulated industries. First, he analyzed the equity returns of a group of thirteen electric utilities which Mr. Jeffries found to be comparable to CEI (CEI Ex. 8A, Exhibit FEJ-9, p. 45). However, Mr. Jeffries rejected the use of these returns, without adjustment, contending that they were too low. Mr. Jeffries pointed out that under today's unique economic conditions the use of historical equity returns would not be appropriate (CEI Ex. 8, p. 20).

The second part of Mr. Jeffries' comparable earnings analysis compares the rate of return earned by CEI to

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

that earned by non-regulated large industrial companies (CEI Ex. 8, p. 21). Mr. Jeffries used Standard & Poor's 400 Industrials to obtain what he perceived to be a broad perspective of the markets in which CEI competes for funds. In comparing CEI to Standard & Poor's (S & P) Industrials, Mr. Jeffries also concluded that such a comparison was proper based upon the assumption that the investor perceives investment in CEI as more risky than investment in the S & P Industrials. The data cited by Mr. Jeffries in support of this belief consists of comparisons of price-book ratios, price earnings ratios, and dividend yields for the S & P 400 to corresponding figures for CEI and the S & P Electric Utilities (CEI Ex. 8, p. 14). Mr. Jeffries finds that the current ratio for CEI is lower than the S & P 400. In addition, he finds CEI's dividend yields higher than that of the S & P 400 (CEI Ex. 8, p. 14). Based upon these observations Mr. Jeffries concluded that CEI's perceived risk is higher than that of the S & P's 400 Industrials. Mr. Jeffries also compares the risk involved in investing in CEI to the historic returns on common equity earned by a group of 68 industrials. In order to be selected as a member of this group, the company's *Value Line* safety ranking had to be the same as CEI's (CEI Ex. 8, p. 21).

The Commission is of the opinion that, although this information is useful as a general background, we cannot select a rate of return using such an analysis. Levels of dividend yields, price-earnings ratios, or market-to-book ratios do not indicate, by themselves, the levels of investment risk on equity capital. Such measurements can be useful in such analysis but there has been no demonstration that CEI is, in fact, comparable to the companies comprising the S & P 400 or the group of 68 other industrials. Therefore, we must reject this analysis.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Mr. Jeffries also performed a risk premium analysis in estimating the cost of common equity (CEI Ex. 8, pp. 23-25). By using this method Mr. Jeffries concluded that the cost of common equity to CEI was 22% (CEI Ex. 8A, p. 5). It must be noted that this estimation is considerably higher than any rate of return granted by this Commission. Even Mr. Jeffries conceded that a rate of return lower than 22% would be appropriate (CEI Ex. 8A, p. 5).

In reaching his recommendation Mr. Jeffries first had to determine the appropriate equity-debt risk spread. He chose 5.8% (CEI Ex. 8, p. 23-33). [The Commission must note that this risk premium is almost double the 3.35% chosen by Mr. Maugans who also testified on behalf of the company (CEI Ex. 4A, p. 6 and Appendix 6, p. 28).] Mr. Jeffries derived the 5.8% from averaging the risk premiums derived in three separate analyses. The first risk premium was derived by a comparison of yields on double-A rated industrial bonds and the return earned on the S & P 400 Industrials (CEI Ex. 8, p. 22). This resulted in a risk premium of 5.8%. The second risk premium was derived from a study of the Financial Research Foundation. This study, by Roger G. Ibbotson and Rex A. Sinquefeld, showed that the investment annual returns for the period 1926-1976 were 11.6% for common stocks and 4.2% for corporate bonds; the equity-debt risk premium was 7.4 percentage points. Ibbotson and Sinquefeld updated their study for the years 1926-1978, and the results were total annual returns of 11.2% for common stocks and 4.1% for long-term corporate bonds resulting in an equity-debt risk premium of 7.1 percentage points (CEI Ex. 8, p. 23).

Another study dated January 1980, by Eugene F. Brigham and Philip K. Shome of the Public Utility Research Center, University of Florida, showed the equity-debt risk premium to average about 5.7 percentage points for the years 1964-1979. The five-year moving average

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

was 7.0 percentage points for 1979. The debt component for this study was government bonds, which generally yield about one percentage point less than double-A utility bonds.

As pointed out by Dr. Marcus, testifying on behalf of OCC, risk is measured by variability of return and risk perceptions are based on actual returns on assets. The greater vulnerability of bondholders, relative to common stockholders, to unexpected inflation is seen in their actual returns, which in recent years were extremely low compared with returns on common stock investments (OCC Ex. 1, III, p. 6). Dr. Marcus pointed out that in the six-year period from 1975 to 1980, investors' return on the S & P 400 stocks, consisting of dividends and capital gains, averaged 17.3 percent annually. However, the average annual return on bonds during the same period was a negative 1 percent. In each of the last three years, returns to bondholders were negative. As a result of this most unusual experience, Dr. Marcus concluded that investors may now consider bonds to be more risky than stocks and their required returns have risen accordingly. Dr. Marcus thus concluded that reliance on current bond yields for estimating the required returns on common equity under these conditions may very well produce erroneous results.

We must agree with Dr. Marcus that, considering recent economic trends, a risk premium approach may lead to incorrect results. Although this information is useful in analyzing current market conditions, the Commission must exercise caution in using such an analysis for a specific rate of return recommendation.

As a preliminary step in reaching a conclusion on an appropriate rate of return on equity, it is evident, given the above discussion, that we must focus our attention on the use of the traditional DCF analysis. As stated on other occasions, we believe that this method provides the best

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

indication of the current cost of equity capital to a given corporation.

Mr. Jeffries, Dr. Marcus and Mr. Farrar all used a DCF analysis to determine a cost of equity component. The three witnesses used the same basic formula to develop their recommendation, although the specific variable inputs differed. Mr. Jeffries, in his original written testimony, used a twelve month average stock price to determine a yield component (CEI Ex. 8, p. 26). In his supplemental testimony Mr. Jeffries also utilized a twelve month ending November 1981 average price of \$14.84 coupled with the current dividend of \$2.16 to determine a yield component of 14.6% (CEI Ex. 8A, p. 4). Mr. Jeffries testified that he felt this figure to be conservative in light of the Supreme Court's decision on the cancelled nuclear plants and the downrating of CEI's bonds in July 1981. In his computation Mr. Jeffries used a growth component of 4% to determine a baseline cost of equity (CEI Ex. 8A, p. 4).

Mr. Farrar used a similar yield component in his estimation of the cost of a baseline return on common equity. Mr. Farrar utilized a twelve month average stock price of \$14.9115 for the twelve months ending January 1982, coupled with the current dividend of \$2.16 to arrive at a yield component of 14.49 percent (Tr. 17, p. 5). In calculating his baseline cost of equity, however, Mr. Farrar utilized a growth component of 2 percent.

In determining a yield component Dr. Marcus utilized yields over the past three years, weighing the most recent months most heavily, to determine a yield component of 13.15 percent (OCC Ex. 1, III, p. 16). Dr. Marcus used a growth rate of two percent in his calculation also.

As noted above Mr. Jeffries and Mr. Farrar were very close in their yield computations, 14.6 percent compared to 14.4 percent. Both used the same basic technique, with Mr. Farrar using data that was somewhat more recent. Dr.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Marcus, on the other hand, used data over the past three years. It has always been the Commission's policy in determining the yield component of the return on common equity to use the most recent data available. We do not believe that the use of three year old yields, although weighted against more recent data, complies with our goal of determining a current cost of equity. We must, therefore, reject Mr. Marcus' proposed yield. In addition, since Mr. Farrar's analysis uses more current data, we select that recommendation of a yield component.

This discussion narrows the scope of inquiry to the growth component of the DCF analysis presented by each of the witnesses. As noted previously the major difference between the positions of the parties centers on the growth component used in the DCF analysis. Mr. Maugans and Mr. Jeffries contend that 4% is appropriate while Mr. Farrar and Dr. Marcus used 2%. In determining a growth component, each of the witnesses looked at various data. Mr. Maugans emphasized that the company has increased its dividend at a 4% growth rate over the past 5 years (CEI Ex. 4, pp. 18-19). Mr. Jeffries indicated that the average growth rates for book value, earnings, and dividends were 4.2%, 2.1%, and 3.4% respectively for the period 1970-1979 (CEI Ex. 8, p. 25). Mr. Jeffries also noted, however, that customer growth for CEI has been below the industry average and was only 3.1% during the five years ending 1980 (CEI Ex. 8, p. 16).

Dr. Marcus utilized a growth component of 2% in implementing the DCF model (OCC Ex. 1, III p. 21). He relied basically on the "b x r" methodology in determining this growth component. Dr. Marcus testified that over the long run, dividends can be expected to grow at the same rate as earnings. Earnings, in turn, are the product of the utility's equity capital and the achieved return on this capital. It follows, therefore, that the utility's earnings

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

growth will, over the long run, largely equal its book equity growth (OCC Ex. 1, p. III-19).

Witness Farrar estimated future growth on the "b x r" method and found that for the most recent five year period, 1976-80, the "b x r" component averages to be 3.12% (Staff Ex. 3, p. 5). However, in each of the past three years the company has had a "b x r" value below any single value over the past ten years. For the past three years, b x r has been only 1.84, 2.48 and 1.30%, respectively. Estimates for 1981 and 1982 are also low. Mr. Farrar also testified that earnings growth has been low. The compound growth rate in earnings per share has been 1.38% for the most recent five year period 1979-80. For the ten year period 1970-80 the value is 1.18%. Log-linear growth rates for both of these time spans are 0.33 and 1.86%, respectively. Given the recent earnings performance Mr. Farrar used a growth component of 2%.

The company contends that the "b x r" methodology for approximating growth is not theoretically valid in this case. Mr. Maugans calls this method an exercise in "circulated reasoning" that is not in actuality adopted by investors (CEI Ex. 4A, p. 18). The company contends that the growth rate in dividends is indicative of the investors' expectations of growth in the company. The Commission, however, does not share these sentiments. The growth rate in dividends cannot be said to be the sole factor investors use to determine expected growth in the company. The investor's growth expectation is certainly also influenced by earning potential as well as customer growth, sales growth, and growth in book value. Based on this analysis the Commission is of the opinion that equal emphasis must be placed on the "b x r" analysis and the earnings growth analysis, as well as the dividend growth analysis, in determining the growth factor for the DCF calculation. This is the approach that was performed by

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Staff witness Farrar. For these reasons we adopt Mr. Farrar's recommendation of a 2% growth rate.

*Adjustments to the baseline cost of Equity*

The Staff has developed a standard procedure of adjusting the baseline cost of equity to account for "flotation costs." All of the rate of return witnesses recommend that some adjustment is necessary; however, that is where the agreement ends. The various witnesses do not agree as to what items should be included in the term "flotation costs", what amounts are to be associated with given items, or what method should be used in applying the items. Although we have recently addressed this topic in *Cincinnati Gas & Electric* Case No. 81-66-EL-AIR et al., *supra*, we feel some additional comments are in order.

There are two areas where OCC disagrees with the Staff's adjustment for flotation costs: first, the proper procedure for incorporating the adjustment into an allowed rate of return. Second, the magnitude of the components to be used in the appropriate method.

The Staff and the applicant use their determination of flotation costs as a direct factor to be applied to the baseline cost of equity. Mr. Miller and Dr. Marcus disagree with this approach claiming that the Staff's approach ignores entirely the question of how much stock CEI will be issuing over the upcoming year (OCC Ex. 4, testimony of Ralph Miller p. 41, OCC Ex. 1 testimony of Dr. Marcus p. IV-3). Both witnesses argue that the company should actually be "compensated" for such expenses that the company will actually incur for flotation costs (OCC Initial Brief p. 40). Both accomplish this by applying their adjustments only to the portion of equity expected to be raised through new sales rather than to CEI's entire book equity (OCC Initial Brief p. 40). Dr. Marcus, for example, asserts that an adjustment applied to the utility's entire book

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

equity would only be needed if the utility had to refinance its entire equity every year (OCC Ex. 1, p. IV-3).

We must disagree. As we have stated on previous occasions the fundamental assumption of a market-based approach is that the cost of equity capital can be equated with the investor's return requirement. The costs associated with the issuance of common stock, however, create a permanent difference between the capital base upon which the company can earn and the total capital supplied by the investors. This difference is not funded through prior rate awards but remains as a permanent gap between what the investor supplied and what the company received. (See, e.g., *Cincinnati Gas & Electric Company*, Case No. 81-66-EL-AIR, et al., *supra*.) We must therefore reject OCC's arguments on this point.

The second issue with respect to flotation costs is what values should be assigned to the individual components of the adjustment factors used. The Staff adjusted the baseline cost of equity by 1.032 to 1.100 to account for flotation costs (Staff Ex. 3, p. 6). In support of the lower end of the Staff's range witness Farrar testified that the 3.2% figure was originally taken from the testimony of OCC witness Ralph E. Miller in testimony presented before the Federal Power Commission in Docket No. Rm 77-1.

The Staff has, however, recently undertaken an independent analysis to verify those costs and found that the average issuance cost was 3.33% (Staff Ex. 3, p. 7). The Staff has also considered several studies to determine the effect of market pressure. The Staff reviewed a paper by William B. Ford and a study by Kidder-Peabody & Co. which indicated respectively that the market pressure is 2% and 2.52% (Staff Ex. 3, p. 7).

The Staff then summed the lower end of the issuance cost range 3.33%, which assumes minimal market pres-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

sure, with the 2.52% market pressure from the Kidder-Peabody study for a total of 5.85%. The next step is estimating the upper bound of the range. The Staff takes the 5.85% figure and calculates the standard deviation in order to determine the figure at which one can be 90% certain falls above the average. The result is 10.86% which is close to the Staff's 10% upper bound (Staff Ex. 3, p. 8).

Dr. Marcus recommends a flotation cost adjustment of 4.0% (OCC Ex. 1, p. IV-3). Dr. Marcus arrived at his 4.0% recommendation based on a study he made of actual flotation costs for all electric utility common equity issues sold from January 1, 1977, through December 31, 1978 (OCC Ex. 1, p. IV-12). One hundred twenty nine issues were studied and both issuance costs and market pressure were considered. Issuance costs were actual figures reported by Ebasco. Dr. Marcus estimated market pressure in each case by comparing the price change for the individual stock during the sale period with the price change in stock index over the same period. Dr. Marcus' study showed that average selling costs for all new electric utility issues was 3.85%: .5% for market pressure, 2.92% for underwriting costs and .43% for other expense (OCC Ex. 1, p. IV-3).

OCC witness Miller also conducted his own study of underwriting costs and market pressure for the period 1976-1981 for the major electric and combination utilities operating in Ohio (OCC Ex. 4, p. 31). The average underwriting spread for all of these issues was 3.2%; other costs amounted to .3%. Mr. Miller's market pressure analysis, combined with his examination of other market pressure studies which he believes to be valid, led him to recommend 0 to 3% for market pressure (OCC Ex. 4, p. 32). Mr. Miller's total range for flotation costs is 3.5% to 6.5%.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Mr. Miller has recommended that a total adjustment of 5% be used in this case.

OCC acknowledges on brief that the flotation cost figure used by the Staff of 5.8% is not that far from the recommendation of Mr. Miller and Dr. Marcus of 5% and 4% (OCC Initial Brief, p. 49). OCC's real objection goes to the use by the Staff of 10% as an upper limit in recommending a range for return on equity (OCC Initial Brief, p. 47). OCC disputed the methodology utilized by the Staff for justification of the 10% figure and recommends a range of 4%-5.8% based on various averages recommended by the witnesses. It is important to note that these numbers, the 4%, 5% and 5.8%, are averages or means of many numbers derived from the various studies performed by the witnesses (Staff Ex. 3, p. 8). The specific value given is an approximation of the cost associated with an issue of new securities. The specific average or mean is used to estimate what the cost would be to a given company, in this case CEI, of issuing new equity capital. The value we are attempting to estimate is called the population parameter and the mean is one estimate of what we expect the actual unknown cost to be.

The Staff adjusts its single point estimate in order to give the Commission a range from which to select a specific return on equity. The Staff performs this adjustment because, for most practical purposes, it is not sufficient merely to have a single point estimate of a population parameter, such as the flotation costs associated with the issuance of new equity capital that we are discussing here. Since the single estimate is undoubtedly incorrect, in the sense that it is extremely improbable that the estimate is exactly equal to the value of the population parameter, it is necessary to have an estimation procedure which gives some measure of the degree of precision involved. The standard procedure in classical statistical infer-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

ence for this purpose is confidence interval estimation. This is the technique employed by the Staff in its recommendation of a range to the Commission with respect to flotation costs. What the Staff is recommending to the Commission is an estimated range, rather than a single point estimate, with a corresponding factor which indicates the degree of certainty that the unknown parameter is actually in the estimated range. We must disagree with OCC's contention that the 10% upper point of the Staff's range is unsupported by the evidence. We are of the opinion that the use of confidence interval estimation is not only proper but desirable in producing a return on common equity. Therefore we adopt the Staff's use of this method and the range presented.

In addition, we must note that applying the range of 4%-5.8% for flotation costs, as recommended by OCC, to the baseline cost of equity of 16.49% that we have adopted in this case, would yield a return on common equity of 17.15%-17.45%. As will be discussed below, we are selecting a rate of return on common equity of 17.30% in this case. It can easily be seen that the selected rate of return falls at the midpoint of the range advocated by OCC. Thus, although we do not adopt the method used by OCC on this issue, we reach the same result.

**Other Considerations:**

After combining the appropriate factors and adjusting them accordingly we are presented with a range of 17.02%-18.13% for a return on common equity. As we have discussed previously, the Staff purposely adjusts its recommendation of a return on equity to present the Commission with an appropriate range rather than a specific point estimation. This method grants to the Commission discretion in selecting a specific point within that

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

range to adjust the rate of return for the specific facts of the case presented.

Frequently the Commission chooses the midpoint of the recommended range and, with respect to CEI, has done so in the company's last three rate cases. However, we are of the opinion that two significant factors presented in the instant case should alter this practice.

The first factor that we believe to be significant is the selection of Period II in this case as the operating period for ratemaking purposes. There can be no question that this decision will grant CEI a better opportunity to earn its authorized return. We feel that this factor, if viewed alone would necessitate the selection of the low point of the Staff's recommended range. However, there is a second factor to be considered.

Both Mr. Maugans (CEI Ex. 4A) and Mr. Jeffries (CEI Ex. 8A) submit that the rate of return on equity granted in this case should be specifically adjusted to account for the increase in investment risk resulting from the decision of the Ohio Supreme Court in *Consumers' Counsel v. Public Utility Commission*, 67 Ohio St. 2d 153 (1981). OCC and the City of Cleveland oppose such a proposition (See e.g., OCC Ex. 1A).

In computing the yield component used in the Staff's DCF calculation, witness Farrar used a 12 month average of applicant's stock price (Staff Ex. 3, p. 3). This is the standard practice used by the Staff in computing a yield component for common equity. Both Mr. Jeffries and Mr. Maugans, however, testified that it would be more appropriate to utilize a yield component derived from available market data subsequent to the Supreme Court's decision of July 1981, in order to reflect the increase in investors' perceived risk associated with the Court's decision. It should be noted that Mr. Maugans testified that Standard and Poor, in lowering CEI's bond rating, specifically

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

cited the Supreme Court's decision as a factor (CEI Ex. 4A, p. 6). We are of the opinion that the increase in investors' perceived risk should be reflected in the return on equity granted in this case. Indeed, the Supreme Court in *Consumers' Counsel v. Public Utilities Commission*, *supra*, specifically acknowledged that its decision in that case could seriously disadvantage Ohio utilities in the capital markets (*Id.* at p. 167). As a result, instead of selecting the low point of the Staff's recommended range, we are of the opinion that the first quartile should be utilized. Thus, the return on equity component is found to be 17.30%.

**Rate of Return Summary:**

Applying a cost of equity of 17.30 percent, a cost of preferred stock of 9.44 percent, and a cost of debt of 9.13 percent to the capital structure approved for purposes of this proceeding yields a weighted cost of capital of 12.25 percent. The Commission therefore concludes that a rate of return of 12.25 percent is sufficient to provide the applicant reasonable compensation for the service it renders to the customers affected by this application.

**AUTHORIZED INCREASE**

A rate of return of 12.25 percent applied to the jurisdictional rate base of \$1,900,527,000, approved for purposes of this proceeding, results in an allowable return of \$232,815,000. Certain expenses must be adjusted if the gross revenues authorized are to produce this dollar return. These adjustments, which have been calculated in a manner consistent with the findings herein, result in an increase in the allowance for federal income tax of \$47,137,000, in the allowance for other taxes of \$4,217,000, and in the allowance for uncollectibles of \$288,000. The net effect

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

of these adjustments is to increase allowable expenses by \$51,642,000. Adding the approved return to these allowable expenses results in a finding that the applicant is entitled to place rates in effect which will generate \$1,166,292,000 in gross annual operating revenues. This represents an increase of \$106,977,000 over the rates which are currently in effect.

**POWERPLANT PRODUCTIVITY**

In the applicant's last rate case, the Commission ordered CEI to submit quarterly reports on the immediate past performance of its generating units to be used in establishing a statewide powerplant productivity data base to assist in monitoring and assessing the performance of Ohio powerplants. Staff witness Evans testified that the company has been submitting such quarterly reports which have demonstrated improvements in the company's performance (Staff Ex. 5, p. 7). The Staff recommended that the company continue to submit quarterly reports of the immediate past performance of CEI's generating units (Staff Ex. 1C, p. 7). We agree with this recommendation and so order the applicant.

**RATES AND TARIFFS**

As a part of its investigation in this matter, the Commission Staff reviewed the rate schedules and the provisions governing the terms and conditions of service contained in the applicant's proposed tariffs. A number of objections were filed relative to this area which will be discussed below. However, some general comments are in order. The proposed rate schedules were designed to generate revenues less than that which the Commission has herein approved; in addition, the positions of the parties in reaching agreement on certain issues may have been

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

based on their assumption that this Commission would approve the use of Period I expenses. Thus, in giving direction to the company in preparing the tariffs authorized herein, it will be necessary to speak in terms of principles to be followed, rather than to set out the specifics of a given rate schedule. The tariffs filed pursuant to this Order will be carefully reviewed prior to their approval to ensure that the Commission's intent has been properly reflected. Consistent with our customary practice, the extent to which the total relief authorized is more than the level of revenues on which the proposed rates were based should be recognized through a proportionate increase in the demand and energy charges of all rate schedules, except as noted.

**Revenue Distribution:**

The issue of interclass revenue distribution was resolved by a stipulation and recommendation (Jt. Ex. 1), joined in by the company, the Staff, OCC, and IEC. Each of the witnesses testifying on this subject found the stipulation to be reasonable, OCC witness Miller and Staff witness Groves testifying that the revenue distribution was consistent with their respective recommendations (Tr. XVI, p. 81; Tr. XIII, p. 147). Considering the wide range of positions represented by the signatories to the agreement, and the support in the record, the Commission finds that the revenue distribution agreed to in Joint Exhibit 1 is reasonable and that it should be adopted. We recognize that the positions of the parties in reaching agreement on this issue may have been based on assumptions which do not comport with our decision to use Period II as the basis for our revenue determination. Should that be a concern to the parties, the Commission would entertain an application for rehearing on this issue, and a supplemental stipulation and recommendation.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

Mr. Groves testified that as a result of the company's including in its filing rate base, expenses, and revenues associated with street lighting, but not requesting an increase in rates for that class, all other classes of customers will subsidize the street lighting class. He therefore recommended that

the Applicant be ordered to either increase the Street Lighting class non-fuel revenue by the average increase granted in this proceeding or that a comparable revenue level be assigned to the Street Lighting Schedule . . . independent of actual revenue recovery levels. Staff Ex. 7, p. 7.

The stipulation and recommendation provides that the agreed revenue distribution would apply to the total revenue requirement "inclusive of fuel and exclusive of revenues deemed appropriate by the Commission for street lighting" (Jt. Ex. 1, p. 1). In determining the revenue distribution, the revenues attributable to the street lighting class should be that which would have been produced by the street lighting rates filed by the company.

**Industrial Rate Design:**

Another stipulation and recommendation (Jt. Ex. 2) was entered into by CEI, the Staff and IEC; the agreement covered the design of the Industrial and Large Industrial Tariff rate schedules. Company witness Bingham believed that the rates agreed to in Joint Exhibit 2 reflect an even better rate design than the rates originally proposed by the company (Tr. IX, p. 103), and Mr. Groves agreed with the stipulation (Tr. XIII, p. 148). The Industrial and Large Industrial rate design reflected in Joint Exhibit 2 should be approved. It is clear that rate levels would change as a result of the revenue level approved herein, and might change if the revenue distribution is readjusted.

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****Residential Customer Charge:**

The company originally proposed a customer charge of \$1.50, lower than the current \$2.50 customer charge. The Staff, using its standard method, calculated the customer charge at \$2.62, and recommends maintaining the current \$2.50 charge (S.R., p. 67). There was some discussion of whether or not the accounts used in the Staff's calculation were properly considered, and OCC's witness Miller presented an additional calculation which led to a \$1.77 figure (OCC Ex. 4, p. 19).

The record on this issue contains not only testimony regarding the proper calculation, but also strong sentiment that the customer charge should be eliminated. In fact, of all of the participants in this proceeding, only the Staff expressed a view in favor of a customer charge. Mr. Bingham testified that he would like the customer charge eliminated (Tr. IX, p. 106), in response to the dislike of such a charge by CEI's customers, a sentiment which was clearly communicated to the Commission by the public statements made in this case (Tr. I, pp. 25, 35, 41, 60).

We note that all of the parties having a direct interest on this issue have expressed the view that the customer charge should be eliminated. The Commission has often expressed *its* view that the customer charge is a reasonable way for utilities to recover costs that do not vary with usage, and to ensure some measure of revenue stability, and in CEI's last case, the record supported, and the parties recommended, a \$2.50 customer charge. In view of those facts, we are not prepared at this point to totally eliminate the customer charge, an element of rate design which we have accepted and approved for many Ohio utilities.

However, the opposition to the customer charge is a factor which we cannot ignore. We will approve the \$1.50

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

customer charge which is proposed by the company and supported by the testimony of OCC witness Miller in this case as an admitted compromise on this issue. We note that this makes the third time in the three cases since the customer charge was first approved for CEI that the customer charge has been reduced, and it may be that the charge will, at some point, be eliminated. The Commission will give this matter additional thought in future cases.

**Time-of-Day Rates:**

In its objections to the Staff Report, the City of Cleveland objected to the Staff's failure to review the company's report to this Commission on its time-of-day rate experiment. Mr. Groves did testify that he has not reviewed the report in depth (Tr. XIII, p. 78). The City and this Commission disagree, however, as to where that leaves us. The City urges the Commission to order the company to expand the experiment (City of Cleveland Initial Brief, p. 52), a request which we must deny. The record does not contain sufficient support for expanding CEI's time-of-day experiment; it certainly does not support the City's contention that the benefits of time-of-day rates have been "demonstrated" (*Id.*) Mr. Grove has indicated that a proper cost/benefit analysis of time-of-day rates would have to be undertaken before any recommendation could be made, and in our opinion, that would have to be done before any order should be made. We overrule the City's objection on this matter.

**Effective Date:**

It has been the customary practice of the Commission to provide in its rate order that tariffs filed pursuant to such orders shall be applicable to service rendered 30 days following the issuance of the entry accepting those tariffs for filing. Recently, the Commission has also offered util-

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

ities the option of notifying their customers with a special mailing; the effective date of the tariffs would then be three days after the notice has been mailed to all customers. The purpose of delaying the effective date of the tariffs has been to afford the customers affected by the rate case notice of the increase authorized, prior to the time those rates go into effect. The Commission continues to believe that this is a reasonable practice, but finds that there are circumstances presented by the instant case which compel a departure from this policy.

Section 4909.42, Revised Code provides that if the Commission has not acted upon a rate application within 275 days of the filing, the applicant utility, upon the filing of any undertaking in an amount determined by the Commission, may place the proposed rates in effect, subject to the condition that amounts charged and collected in excess of those finally determined to be reasonable by the Commission shall be refunded. The Commission makes every effort to issue its rate orders in advance of the expiration of the 275 day time period, in order to avoid the customer confusion which might result under the refund provision. This was not possible in the instant case, due to the number and complexity of the issues involved. The Commission therefore finds that the appropriate course in this case is to establish the effective date of the tariffs filed pursuant to this order as the date they are approved by Commission entry. The customary notification requirement will of course, be retained, and such notice should be mailed to customers upon approval of its form by the Commission.

**FINDINGS OF FACT:**

From the evidence of record in this proceeding, the Commission now makes the following findings:

- 1) The value of all of the applicant's property used and useful for the rendition of electric service to

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

the customers affected by this application, determined in accordance with Sections 4909.05 and 4909.15, Revised Code, as of the date certain of March 31, 1981, is not less than \$1,900,527,000.

- 2) For the twelve month period ending December 31, 1982, the test period approved by the Commission in this proceeding, the revenues, expenses, and income available for fixed charges that would have been realized by applicant under the permanent rate schedules in effect when the case was filed are \$1,059,315,000 \$881,835,000, and \$177,480,000, respectively.
- 3) This net annual compensation of \$177,480,000 represents a rate of return of 9.34 percent on the jurisdictional rate base of \$1,900,527,000.
- 4) A rate of return of 9.34 percent is insufficient to provide the applicant reasonable compensation for the electric service rendered to customers affected by this application.
- 5) A rate of return of 12.25 percent is fair and reasonable under the circumstances presented by this case and is sufficient to provide the applicant just compensation and return on the value of its property used and useful in furnishing the service described in the application.
- 6) A rate of return of 12.25 percent applied to the rate base of \$1,900,527,000 will result in income available for fixed charges in the amount of \$232,815,000.
- 7) The allowable annual expenses of the applicant for purposes of this proceeding are \$933,477,000.
- 8) The allowable gross annual revenue to which the applicant is entitled for purposes of this proceeding is the sum of the amounts stated in Findings 6 and 7, or \$1,166,292,000.
- 9) The applicant's present tariffs should be withdrawn and cancelled and the applicant should

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

submit new tariffs consistent in all respects with the discussion and findings set forth above.

- 10) The tariffs submitted by the applicant shall contain base (or non-fuel) rates and charges sufficient to yield gross revenues which will compensate the company for allowable test period operating expenses, exclusive of fuel costs includable in its fuel adjustment clause calculation, and yield a 12.25 percent rate of return on its rate base of \$1,900,527,000.
- 11) The applicant should continue to submit quarterly reports, in a form to be agreed upon by the applicant and the staff, detailing the immediate past performance of its generating units.

**CONCLUSIONS OF LAW:**

- 1) The application herein is filed pursuant to, and this Commission has jurisdiction thereof, under the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code; further, the applicant complied with the requirements of the aforesaid statutes.
- 2) A staff investigation has been conducted and a report duly filed and mailed and public hearings have been held herein, the written notice thereof having complied with the requirements of Section 4909.19, Revised Code.
- 3) The existing rates and charges as set forth in the applicant's tariffs governing service to customers affected by this application are insufficient to provide the company with adequate net annual compensation and return on its property used and useful in the rendition of electric service.
- 4) A rate of return of 12.25 percent is fair and reasonable under the circumstances of this case and is sufficient to provide the applicant just compensation and return on its property used and

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

useful in the rendition of electric service to its customers.

- 5) The applicant should be authorized to cancel and withdraw its present tariffs on file with the Commission and to file tariffs consistent in all respects with the discussion and findings set forth above.

**ORDER:**

It is therefore,

ORDERED, That the application of The Cleveland Electric Illuminating Company for authority to increase its rates and charges for electric service be granted to the extent provided in this Opinion and Order. It is, further,

ORDERED, That the applicant be, and hereby is, authorized to file new tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) complete copies of tariffs conforming to this Opinion and Order, the Commission will review and approve those tariffs by entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date those tariffs are accepted for filing. The rates included therein shall be applicable to all service rendered on and after the effective date. The applicant shall immediately commence notification of customers of the increase in rates authorized herein by insert or attachment to its billings, by special mailing, or by a combination of the above. The applicant shall submit a proposed form of notice to the Commission when it files its tariffs for approval and the Commission will review that notice, and if proper, approve it by entry. It is, further,

ORDERED, That the applicant cease to accrue AFUDC at a net of tax factor other than the complement of the Federal Income Tax rate. It is, further,

**Opinion and Order, PUCO Case No. 81-146-EL-AIR**

ORDERED, That the applicant shall continue to submit quarterly reports of the immediate past performance of its generating units, and to upgrade and implement its current programs. It is, further,

ORDERED, That all pending objections and motions not specifically discussed in this opinion and order or rendered moot thereby are hereby overruled and denied. It is, further,

ORDERED, That a copy of this Opinion and Order be served on all parties of record.

**THE PUBLIC UTILITIES  
COMMISSION OF OHIO**

/s/ JON F. KELLY

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(Chairman)

/s/ DENNIS PINES

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/s/ MICHAEL DELBANE

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(Commissioners)

Entered in the Journal  
MAR 17 1982

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A True Copy

DAVID M. POLK

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David M. Polk  
Secretary

**Opinion and Order, PUCO Case No. 81-146-EL-AIR****BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company for authority to increase its  
filed schedules fixing rates and charges  
for electric service.

Case No.  
81-146-EL-AIR

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company to Recover Increases in the  
Public Utility Excise Tax on Gross  
Receipts by alternative methods  
than that Provided by Case  
No. 81-1408-AU-UNC.

Case No.  
81-1565-EL-UNC

**DISSENTING OPINION**

I dissent from the majority's decision to retain the residential customer charge at the \$1.50 level. I believe we should have eliminated the charge in this case, and taken up the question of customer charges as it is presented in future cases.

**THE PUBLIC UTILITIES  
COMMISSION OF OHIO**

/s/ JON F. KELLY

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Jon F. Kelly, Chairman

Entered in the Journal  
MAR 17 1982

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A True Copy

DAVID M. POLK

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David M. Polk  
Secretary

# THE SUPREME COURT OF THE STATE OF OHIO

THE STATE OF OHIO, }	1982 Term
CITY OF COLUMBUS. }	To wit: July 29, 1982

CLEVELAND ELECTRIC ILLUMINATING CO., <i>Appellant,</i>	} <b>No. 82-165 REHEARING</b>
vs.	
PUBLIC UTILITIES COMMISSION OF OHIO, <i>Appellee.</i>	

It is ordered by the court that rehearing in this case is denied.

I, THOMAS L. STARTZMAN, Clerk of the Supreme Court of the State of Ohio, do hereby certify that the foregoing entry was correctly copied from the records of said Court, to wit, from Journal No. \_\_\_\_\_ Page \_\_\_\_\_.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of the Supreme Court this 29th day of July, 1982.

THOMAS L. STARTZMAN,  
*Clerk.*

By \_\_\_\_\_,  
*Deputy.*

# THE SUPREME COURT OF THE STATE OF OHIO

THE STATE OF OHIO, }  
CITY OF COLUMBUS. }

1982 Term

To wit: July 7, 1982

CLEVELAND ELECTRIC  
ILLUMINATING CO.,  
*Appellant,*  
vs.  
PUBLIC UTILITIES  
COMMISSION OF OHIO,  
*Appellee.*

No. 82-165  
APPEAL  
FROM THE  
PUBLIC UTILITIES  
COMMISSION  
OF OHIO  
ON MOTION  
TO DISMISS

This cause, here on appeal from the PUBLIC UTILITIES COMMISSION, was heard in the manner prescribed by law. On consideration thereof, the motion to dismiss is sustained and cause dismissed.

It is ordered that a mandate issue to the PUBLIC UTILITIES COMMISSION OF OHIO to carry this judgment into execution.

I, THOMAS L. STARTZMAN, Clerk of the Supreme Court of Ohio, certify that the foregoing entry was correctly copied from the Journal of this Court.

Witness my hand and the seal of the Court this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_\_.

\_\_\_\_\_  
*Clerk*

\_\_\_\_\_  
*Deputy*

# THE SUPREME COURT OF THE STATE OF OHIO

THE STATE OF OHIO, }  
CITY OF COLUMBUS. }

1982 Term

To wit: July 7, 1982

CLEVELAND ELECTRIC  
ILLUMINATING CO.,  
*Appellant,*  
vs.  
PUBLIC UTILITIES  
COMMISSION OF OHIO,  
*Appellee.*

No. 82-165  
MANDATE

To the Honorable PUBLIC UTILITIES COMMISSION OF OHIO, Within and for the County of Franklin, Ohio, Greeting:

The Supreme Court of Ohio commands you to proceed without delay to carry the following judgment in this cause into execution:

Motion to dismiss sustained and appeal dismissed.

THOMAS STARTZMAN,  
*Clerk*

\_\_\_\_\_, 19\_\_\_\_

\_\_\_\_\_*Deputy*

## RECORD OF COSTS

Docket Fee \_\_\_\_\_ \$20.00 Paid by Squire, Sanders & Dempsey

## BEFORE

## THE PUBLIC UTILITIES COMMISSION OF OHIO

IN THE MATTER OF THE  
 INVESTIGATION OF THE  
 RATES OF THE  
 CLEVELAND ELECTRIC  
 ILLUMINATING COMPANY.

Case No.  
 81-1096-EL-COI

## ENTRY ON REHEARING

The Commission, coming now to consider the above-entitled matter, and specifically its Opinion and Order in this case issued October 21, 1981, the application for rehearing filed by the Cleveland Electric Illuminating Company (CEI) on November 18, 1981, and the memorandum contra filed by the Office of Consumers' Counsel (OCC) on November 30, 1981, hereby issues the following entry on rehearing.

## Commission Review and Discussion

In the two most recent rate proceedings involving CEI, Case No. 79-537-EL-AIR, Opinion and Order July 10, 1980 and Case No. 80-376-EL-AIR, Opinion and Order May 4, 1981, we have included in CEI's allowable test year expenses the amortization of CEI's share of the costs associated with the cancellation of four nuclear plants. On appeal of the decision in Case No. 79-537-EL-AIR, the Ohio Supreme Court found that the inclusion of those costs was unreasonable and unlawful. *Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St. 2d 153 (1981). In order to implement the directives of the Supreme Court in that decision we initiated this investigation, pursuant to Section 4905.26, Revised Code, and by Order dated Oc-

**Entry on Rehearing, PUCO Case No. 81-1096-EL-COI**

tober 21, 1981, directed CEI to remove these costs from its current rates.

On November 18, 1981 CEI filed an application for rehearing setting forth nine areas of alleged error. OCC filed a memorandum contra on November 30, 1981. In part, CEI contends that these proceedings were initiated, conducted and determined without authority of law. In addition, CEI claims that it was improper for this hearing to be conducted without the taking of evidence, and that such procedure has deprived CEI of its statutory and constitutional rights. The company also submits that the Commission deviated from prior Ohio law by eliminating a single item from expenses without taking into consideration all aspects of the company's current condition. In sum, CEI contends:

[t]he said Opinion and Order, by its failure to recognize and allow recovery of prudent expenditures made in the interest of providing public service and as mandated by statute, contravenes the public policy of the State of Ohio, unlawfully imperils the future rendition of reliable utility service, unlawfully deprives respondent of its property, and unreasonably impinges on the financial security of all Ohio utilities and hence upon the cost and reliability of utility service rendered to Ohio consumers. (Application p. 4)

We are not unmindful of the position taken by CEI and the uniqueness of the situation that is before us. However, we believe that the intent of the Supreme Court was that positive steps be taken to grant CEI consumers rate relief as a result of its decision. As we stated previously in our Opinion and Order, we are of the opinion that the best method of implementing the intent of the Supreme Court's decision in *Consumers' Counsel v. Public Utilities Commission*, *supra*, is the method we have chosen. In light of that decision, the objections raised by CEI must be overruled and rehearing denied.

**Entry on Rehearing, PUCO Case No. 81-1096-EL-COI**

It is, therefore,

ORDERED, That the rehearing application filed November 18, 1981 by The Cleveland Electric Illuminating Company be denied. It is, further,

ORDERED, That copies of this Entry on Rehearing be served on all parties of record.

**THE PUBLIC UTILITIES  
COMMISSION OF OHIO**

/s/ JOHN KELLY

(Chairman)

/s/ DENNIS PINES

/s/ MICHAEL DELBANE

(Commissioners)

Entered in the Journal

December 9, 1981

A True Copy

DAVID M. POLK

David M. Polk  
Secretary

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

IN THE MATTER OF THE  
INVESTIGATION OF THE  
RATES OF THE  
CLEVELAND ELECTRIC  
ILLUMINATING COMPANY.

} Case No.  
81-1096-EL-COI

**OPINION AND ORDER**

The Commission, coming now to consider the above-entitled matter, having reviewed the arguments introduced at public hearing and the briefs of the parties, and being fully advised of the facts and issues in this case, hereby issues its Opinion and Order.

**Appearances:**

Mr. Alan D. Wright, General Counsel, and Mr. Craig I. Smith, Senior Counsel, 55 Public Square, Cleveland, Ohio, and Messrs. Squire, Sanders & Dempsey, by Mr. Alan P. Buchmann, 1800 Union Commerce Building, Cleveland, Ohio, on behalf of the Applicant, The Cleveland Electric Illuminating Company.

Mr. William J. Brown, Attorney General of Ohio; by Mr. Marvin I. Resnik, Mrs. Marsha Rockey Schermer and Mr. Jonathan L. Heller, Assistant Attorneys General, 375 South High Street, Columbus, Ohio, on behalf of the Staff of the Public Utilities Commission of Ohio.

Mr. William A. Spratley, Consumers' Counsel, by Ms. Gretchen J. Hummel, Mr. Martin J. Marz and Mr. Steven M. Sherman, Associate Consumers' Counsel, 137 East State Street, Columbus, Ohio, on behalf of the residential customers of The Cleveland Electric Illuminating Company.

Mr. Thomas E. Wagner, Director of Law, and Mr. Craig Glazer, Assistant Director of Law, Cleveland City

**Opinion and Order, PUCO Case No. 81-1096-EL-COI**

Hall, 601 Lakeside Avenue, Cleveland, Ohio, on behalf of the City of Cleveland, Ohio.

Messrs. Bell & Clevenger, L.P.A., by Messrs. Langdon D. Bell and Samuel C. Randazzo, 21 East State Street, Columbus, Ohio, on behalf of the Industrial Electricity Consumers.

**History of the Proceedings:**

In its Opinion and Order of July 10, 1980 in Case No. 79-537-EL-AIR, and in the May 4, 1981 Opinion and Order in Case No. 80-376-EL-AIR, the last two rate proceedings involving The Cleveland Electric Illuminating Company (CEI), the Commission authorized the inclusion in allowable expenses of the amortization of CEI's share of the costs associated with the cancellation of four nuclear plants. On appeal of the decision in Case No. 79-537-EL-AIR, the Ohio Supreme Court found that the inclusion of those costs was unreasonable and unlawful. *Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St. 2d 153 (1981). In light of that decision, the Commission initiated this investigation of CEI's rates, pursuant to Section 4905.26, Revised Code, by Entry dated September 16, 1981.

The decision of the Supreme Court of Ohio in *Consumers' Counsel v. Public Utilities Commission*, *supra*, was reported on July 19, 1981. Issuance of the Court's mandate, however, was stayed, pursuant to Supreme Court Rule IX, Section 2, by the filing of an application for rehearing by CEI. The application for rehearing was denied by Supreme Court Entry dated September 1, 1981, and the Court issued its mandate. Promptly, CEI filed a motion for a stay of the mandate which was denied by the Supreme Court of Ohio on September 11, 1981. On September 2, 1981, CEI filed with the Supreme Court of Ohio a notice of appeal to the United States Supreme Court and

**Opinion and Order, PUCO Case No. 81-1096-EL-COI**

on September 22, 1981, CEI applied to the United States Supreme Court for a stay of the execution of the mandate of the Ohio Supreme Court. The application for a stay to the United States Supreme Court was denied on October 13, 1981.

Pursuant to the Commission Entry of September 16, 1981 a prehearing conference was held in this matter on September 23, 1981. At that time it was decided that briefs would be submitted by the parties and that the hearing scheduled for October 13, 1981 would be limited to oral argument on the briefs. The hearing was conducted on October 13, 1981 and the record certified to this Commission for appropriate action.

The parties hereto are The Cleveland Electric Illuminating Company (CEI or Company), the Office of the Consumers' Counsel (OCC), the City of Cleveland (City) and the Industrial Electric Consumers (IEC), the latter three having been granted leave to intervene by entry or ruling at the hearing held on October 13, 1981. A petition to intervene filed by Senior Citizens, et al. was denied by the attorney examiner by entry of October 8, 1981, and no appeal to the Commission has been taken.

**Commission Review and Discussion:**

The issue before the Commission at this time is the selection of an appropriate method for implementing the mandate issued by the Supreme Court of Ohio on September 1, 1981. This issue is clouded, however, by complexities that are beyond the control of this Commission or any of the parties appearing before it. The mandate issued by the Supreme Court of Ohio was issued in Commission Case No. 79-537-EL-AIR, Opinion and Order issued July 10, 1979. The rates for electric service authorized and established in Case No. 79-537-EL-AIR were found to be unreasonable and, therefore were, supplanted by those rates established by the Commission in Case No. 80-376-EL-AIR, Opinion and Order issued May 4, 1981. In Case

**Opinion and Order, PUCO Case No. 81-1096-EL-COI**

No. 80-376-EL-AIR the Commission also allowed the annual amortization of the costs associated with the cancelled nuclear plants as part of operating expenses for rate making purposes. No appeals from that aspect of the Commission's decision are pending.<sup>1</sup> In addition, the Company has another rate case pending in Case No. 81-146-EL-AIR, based upon a more current test year, which should commence hearings in late 1981 or early 1982. Thus, although the mandate issued by the Court is clear in its intent, the intent of the Court as to how it is to be implemented may not be.

As noted, the Commission could implement the Court's decision in one of several ways. First of all it could conduct an investigation of the rates established in Case No. 79-537-EL-AIR, although clearly this would be a meaningless exercise. The Commission could simply reduce the rates currently in effect by virtue of Case No. 80-376-EL-AIR by an amount equal to the amortization adjustment; this would ignore, however, all other changes in circumstance that have occurred since the implementation of those rates. Or the Commission could apply the mandate of the Supreme Court on a prospective basis in Case No. 81-146-EL-AIR, which will commence hearings in a few months. The Commission, however, has chosen to implement the Supreme Court's mandate through the initiation of this proceeding. We believe that this is the best method to effectuate the Supreme Court's mandate in the most expedient fashion.

The Office of Consumers' Counsel (OCC) and the City of Cleveland both contend that the remand of the Supreme Court of Ohio requires that this Commission immediately redetermine CEI's allowable operating ex-

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<sup>1</sup> It should be noted that intervenor Senior Citizens, et al., noticed an appeal, which appeal is presently pending, which did raise the issue of the lawfulness of the inclusion of the amortization in allowable expenses. By letter dated September 3, 1981, Senior Citizens, et al., notified the Court that it would not pursue that issue.

**Opinion and Order, PUCO Case No. 81-1096-EL-COI**

penses excluding therefrom the expenditures attributable to the cancelled nuclear facilities and reduce CEI's current rates accordingly. OCC and the City of Cleveland contend that the order of the Supreme Court was specifically directed to a single issue and that changes that may have taken place in other items since the establishment of these rates need not be considered. The City of Cleveland and OCC contend that the adjustment can be made on the data available to the Commission in the most recent rate proceeding. In essence, these parties contend that this Commission should apply the remand of Case No. 79-537-EL-AIR to Case No. 80-376-EL-AIR in a simplistic fashion. The problem, of course, is that CEI's present rates were fixed not in Case No. 79-537-EL-AIR, but in Case No. 80-376-EL-AIR, and there is no remand or mandate in the latter.

The Company contends that the rates established in Case No. 80-376-EL-AIR are presumptively just and reasonable pursuant to Section 4909.15, Revised Code, and the Supreme Court's decision in the prior rate case does not change this presumption. The Company contends that the decision of the Supreme Court should not result in an automatic adjustment of previously-established rates.

In the alternative, the Company contends that if the Supreme Court decision is deemed a sufficient basis for the institution of an investigation into the current rates, such an investigation must consider more than a single item subtracted from the Company's allowable expenses. The Company points out that the test period in Case No. 80-376-EL-AIR was the calendar year 1980, and that we are currently through most of 1981 and a great number of the circumstances have changed. The Company contends that in order to make a determination that CEI's rates should be reduced, this Commission must consider more than the one expense item dealt with by the Supreme Court. The Company points out that the theories behind rate making and the test year concept do not provide for

**Opinion and Order, PUCO Case No. 81-1096-EL-COI**

an item by item guaranteed dollar-for-dollar recovery, but rather the establishment of a reasonable allowance for a normal and necessary utility function. The Company argues that although the Supreme Court has stated that the abandonment loss can no longer be considered in establishing this "reasonable allowance", it does not necessarily follow that it must be removed from a reasonable allowance established in the past, without considering all of the elements that make up that allowance.

A further complicating factor is that we are not concerned solely with the inclusion in rates of this expense, but with the impact of the disallowance of the same, requiring careful consideration of all of the implications of such disallowance on the accumulated deferred balances being amortized. Some of those implications were discussed in the Commission's Opinion in Case No. 79-537-EL-AIR and their significance was indicated in Ohio Edison, Case No. 81-898-EL-AEM. The potential influence on the cost of capital and the financial standing of CEI should not be overlooked.

The Commission, thus, is confronted with a series of involved and inter-related problems. In the first instance, it cannot meaningfully act directly on the remand, because the remand is in a case which has since been superseded. Similarly, we must reject OCC's request (OCC Brief p. 5) that we calculate CEI's allowable expenses "based upon the test year data in the remand proceeding," which is the 1979 data while CEI's present rates are based on a 1980 test year. On the other hand, CEI's argument that we must, in effect, conduct a new rate case now seems impracticable in view of the fact that hearings should be conducted in the relatively near future in Case No. 81-146-EL-AIR in which the adequacy of CEI's present rates may be fully explored. The Commission does not mean to say that it is appropriate or, even for that matter, lawful, generally speaking, to adjust rates by a single item because of events occurring after its decision nor, conversely, that

**Opinion and Order, PUCO Case No. 81-1096-EL-COI**

the technical status of a case or series of cases should be employed to promote form over substance. We believe that a practicable solution is required and that the basic thrust of the Ohio Supreme Court's decision in *Consumers' Counsel v. Public Utilities Commission*, *supra*, can be implemented in these circumstances, while preserving the legal rights of the utility. In a sense, the fact that the rates set in Case No. 79-537-EL-AIR have been superseded in Case No. 80-376-EL-AIR is, as a practical matter, counter-balanced by the fact that rates set in Case No. 80-376-EL-AIR will, presumably, soon be superseded in Case No. 81-146-EL-AIR.

The Commission concludes, therefore, that CEI should be directed to file tariffs which reduce its present rates. The Commission is mindful, however, that CEI's appeal to the United States Supreme Court is still pending and that CEI has stated that it intends to pursue that appeal vigorously. In order to obviate any future questions with respect to the amount foregoing through this rate reduction, therefore, CEI is authorized and directed to maintain the same in the appropriate deferred reserves. Such reserves, including this presently foregone amortization, should be maintained by CEI pending a final decision on the lawfulness of the inclusion of these costs in allowable expenses for rate-making purposes or such action as the Commission may take after a full review of all aspects of this question in CEI's pending electric rate case. Obviously, if CEI should eventually prevail on its appeal to the United States Supreme Court, this will do no more than temporarily postpone the recovery of these costs while, in the meantime, CEI consumers will receive the present rate relief which we believe the Ohio Supreme Court expected and which the intervening parties have requested. The Commission will also be able in the context of a full rate case, to consider all of the implications of the Ohio Supreme Court's decision and take such pertinent action as it may deem appropriate.

**Opinion and Order, PUCO Case No. 81-1096-EL-COI****ORDER:**

It is, therefore,

ORDERED, That The Cleveland Electric Illuminating Company submit tariffs for the approval of this Commission, reducing its present rates by an amount equal to the revenue requirements attributable to the cancelled nuclear facilities included therein. It is, further,

ORDERED, That The Cleveland Electric Illuminating Company submit three (3) complete copies of the tariffs by October 26, 1981, to be reviewed by the Commission and approved by subsequent entry. It is, further,

ORDERED, That The Cleveland Electric Illuminating Company continue to defer the accumulated amounts, including the amounts which would have been amortized but for this rate reduction, on its books, as part of the presently accrued deferred reserves with respect to such costs, pending further direction from this Commission and that, at the time it submits the tariffs required by the preceding paragraph of this order, it submit to the Commission's accounting staff the details of the accounting procedures by which it intends to maintain such deferral. It is, further,

ORDERED, That a copy of this Opinion and Order be served on all parties of record in this proceeding.

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

/s/ JOHN KELLY

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(Chairman)

/s/ DENNIS PINES

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/s/ MICHAEL DELBANE

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(Commissioners)

Entered in the Journal  
Oct. 21, 1981

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A True Copy  
DAVID M. POLK

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David M. Polk  
Secretary

**DECISIONS OF THE SUPREME COURT OF OHIO  
DENYING MOTION FOR STAY**

(Filed September 11, 1981)

**THE SUPREME COURT OF THE STATE OF OHIO**

THE STATE OF OHIO, } CITY OF COLUMBUS. }	1982 Term To wit: September 11, 1981
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Office of Consumers' Counsel Senior Citizens Coalition et al., City of Cleveland, Appellants  vs.  Public Utilities Commission of Ohio, Appellees.	}          }	No. 80-1480 No. 80-1528 No. 80-1547
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Upon consideration of the motion for stay of execution of mandate, it is ordered by the court that this motion be, and the same hereby is, denied.

I, THOMAS L. STARTZMAN, Clerk of the Supreme Court of the State of Ohio, do hereby certify that the foregoing entry was correctly copied from the records of said Court, to wit, from Journal No. \_\_\_\_\_ Page \_\_\_\_\_.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of the Supreme Court this \_\_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_\_.

\_\_\_\_\_  
Clerk.

By \_\_\_\_\_,  
Deputy.

**DECISIONS OF THE SUPREME COURT OF OHIO  
DENYING REHEARING**

(Filed September 1, 1981)

**THE SUPREME COURT OF THE STATE OF OHIO**

THE STATE OF OHIO, }	1981 Term
CITY OF COLUMBUS. }	To wit: September 1, 1981
CITY OF CLEVELAND,	} No. 80-1547 REHEARING
<i>Appellant,</i>	
vs.	
PUBLIC UTILITIES	
COMMISSION OF OHIO et al.,	
<i>Appellees.</i>	

It is ordered by the court that rehearing in this case is denied.

I, THOMAS L. STARTZMAN, Clerk of the Supreme Court of the State of Ohio, do hereby certify that the foregoing entry was correctly copied from the records of said Court, to wit, from Journal No.     Page     .

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of the Supreme Court this 1st day of September, 1981.

THOMAS L. STARTZMAN,  
*Clerk.*

By \_\_\_\_\_,  
*Deputy.*

(Filed September 1, 1981)

**THE SUPREME COURT OF THE STATE OF OHIO**

THE STATE OF OHIO, } 1981 Term  
CITY OF COLUMBUS. } To wit: September 1, 1981

SENIOR CITIZENS COALITION  
et al.,  
*Appellants,*  
vs.  
PUBLIC UTILITIES  
COMMISSION OF OHIO et al.,  
*Appellees.*

No. 80-1528  
REHEARING

It is ordered by the court that rehearing in this case is denied.

I, THOMAS L. STARTZMAN, Clerk of the Supreme Court of the State of Ohio, do hereby certify that the foregoing entry was correctly copied from the records of said Court, to wit, from Journal No. — Page —.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of the Supreme Court this 1st day of September, 1981.

THOMAS L. STARTZMAN,  
*Clerk.*

By \_\_\_\_\_,  
Deputy.

DECISIONS OF THE SUPREME COURT OF OHIO  
DENYING REHEARING

(Filed September 1, 1981)

THE SUPREME COURT OF THE STATE OF OHIO

THE STATE OF OHIO, }	1981 Term
CITY OF COLUMBUS. }	To wit: September 1, 1981
OFFICE OF CONSUMERS'	} No. 80-1480
COUNSEL,	
<i>Appellant,</i>	
vs.	
PUBLIC UTILITIES	} REHEARING
COMMISSION OF OHIO et al.,	
<i>Appellees.</i>	

It is ordered by the court that rehearing in this case is denied.

I, THOMAS L. STARTZMAN, Clerk of the Supreme Court of the State of Ohio, do hereby certify that the foregoing entry was correctly copied from the records of said Court, to wit, from Journal No. .... Page ....

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of the Supreme Court this 1st day of September, 1981.

THOMAS L. STARTZMAN,  
*Clerk.*

By \_\_\_\_\_,  
*Deputy.*

# DECISION AND OPINION OF THE SUPREME COURT OF OHIO

(Filed July 15, 1981)

## Statement of the Case.

OFFICE OF CONSUMERS' COUNSEL, APPELLANT, v.  
PUBLIC UTILITIES COMMISSION OF OHIO ET AL., APPELLEES.

SENIOR CITIZENS COALITION ET AL., APPELLANTS, v.  
PUBLIC UTILITIES COMMISSION OF OHIO ET AL., APPELLEES.

CITY OF CLEVELAND, APPELLANT, v.  
PUBLIC UTILITIES COMMISSION OF OHIO ET AL., APPELLEES.

[Cite as Consumers' Counsel v. Pub. Util. Comm. (1981),  
67 Ohio St. 2d 153.]

*Public Utilities Commission—Electric companies—Rate increase—Allowable operating expenses—Amortization of cost of terminated nuclear facilities, unlawful.*

The Public Utilities Commission's treatment of a utility's investment in terminated nuclear generating stations as amortizable costs to be recovered from the utility's ratepayers is inconsistent with the ratemaking formula contained in R. C. 4909.15 and is unreasonable and unlawful.

(Nos. 80-1480, 80-1528 & 80-1547—  
Decided July 15, 1981.)

APPEALS from the Public Utilities Commission of Ohio.

These three cases are appeals taken from an order of appellee, Public Utilities Commission of Ohio (hereinafter "commission"), granting intervening appellee, the Cleveland Electric Illuminating Company (hereinafter "CEI"), a rate increase of approximately \$69.6 million. The commis-

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Statement of the Case.**

sion order further provided for the amortization over a ten-year period of CEI's substantial investment in four terminated nuclear power plants.<sup>1</sup>

The commission's order dealt with two cases that had been consolidated. Case No. 79-537-EL-AIR involved CEI's application to increase rates. Case No. 79-744-EL-CMR concerned a complaint and appeal taken by CEI from a 1979 rate setting ordinance passed by the City of Cleveland.

Inasmuch as these three appeals primarily concern issues relating to the nuclear power plant cancellations, we shall briefly reprise the history of these now terminated facilities. In 1967, CEI joined with four other electric companies to form the Central Area Power Coordination Group (CAPCO).<sup>2</sup> The CAPCO companies sought to achieve economies of scale and greater service reliability by jointly planning, constructing, and operating electrical generating facilities. In 1973, the CAPCO group committed itself to build the four nuclear plants at issue herein based on forecasts that predicted a substantially increased demand for electricity by the CAPCO companies' customers during the 1970's and 1980's. These forecasts subsequently had to be revised downward when increasing energy costs spurred conservation efforts and significantly softened the demand for electricity. Moreover, the 1979 accident at Three Mile Island prompted the Nuclear Regulatory Commission to issue stringent and costly new standards for nuclear power plants, requiring major design changes in the Babcock and Wilcox units that CAPCO planned to construct and oper-

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<sup>1</sup> Davis-Besse Units 2 and 3 and Erie Units 1 and 2 are the cancelled facilities at issue.

<sup>2</sup> In addition to CEI the CAPCO group consists of Toledo Edison, Ohio Edison, and two Pennsylvania utilities, Duquesne Light Co. and Pennsylvania Power Co.

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Statement of the Case.**

ate. After much study and redesign the CAPCO companies decided to terminate the four units on January 23, 1980. When the decision to cancel the plants was announced, CAPCO had already invested considerable sums in the projects. Preliminary expenses included expenditures for engineering, siting, environmental, geological, and seismic studies, and for obtaining state and federal licenses. Moreover, to comply with detailed regulatory requirements and complete all the necessary documents, certain plant components had to be purchased at a fairly early stage in the planning process. CEI's share of the total CAPCO investments in the four cancelled plants amounted to approximately \$56,400,000 as of the date of termination.

The instant CEI rate case was pending before the commission when the plant terminations were announced.<sup>1</sup> The commission had accepted CEI's application for a rate increase as of September 17, 1979, and had established calendar year 1979 as the test year and June 30, 1979, as the date certain. The commission staff conducted an investigation and issued its initial report in March 1980. This report did not make reference to the terminated nuclear plants because CEI did not officially inform the commission of the plant cancellations until February 1980. The commission staff, at appellants' request, then conducted a supplemental investigation to consider the effect of the terminated plant expenditures on CEI's rate application. The staff completed its investigation of the cancelled nuclear facilities and filed revised schedules in mid-April. The staff recommended that the investment in the four nuclear plants should be amortized over a ten-year period as CEI had requested.

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<sup>1</sup> The rates established by the commission order in the instant ratemaking case have recently been superseded by new rates set by order on May 4, 1981 in case No. 80-376-EL-AIR.

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

Public hearings on the rate increase application began on April 2, 1980, and continued for 32 days. Staff witnesses appeared and testified at the hearings in regard to the cancelled nuclear plants and other matters contained in the application. Appellants were represented at, and participated fully in, these public hearings.

The commission issued its order on July 10, 1980. Appellants timely filed for a rehearing which the commission denied as to the issues raised in the present appeal.

These causes are now before this court upon appeals as of right.

*Mr. William A. Spratley*, consumers' counsel, *Mr. Gary M. Petroff* and *Ms. Gretchen J. Hummel*, for appellant Consumers' Counsel.

*Mr. Joseph P. Meissner*, for appellants Senior Citizens Coalition *et al.*

*Mr. Thomas E. Wagner*, director of law, and *Mr. Craig A. Glazer*, for appellant City of Cleveland.

*Mr. William J. Brown*, attorney general, *Mr. Marvin I. Resnik* and *Mr. David M. Neubauer*, for appellee Public Utilities Commission.

*Mr. Alan D. Wright*, *Mr. Craig I. Smith*, *Messrs. Squire, Sanders & Dempsey*, *Mr. Alan P. Buchmann*, *Mr. Lowell L. Garrett*, *Mr. William C. Donahue* and *Mr. Richard W. McLaren, Jr.*, for intervenor-appellee The Cleveland Electric Illuminating Co.

SWEENEY, J. The scope of this court's review of commission orders is set forth in R. C. 4903.13, which states in pertinent part:

"A final order made by the public utilities commission shall be reversed, vacated, or modified by the supreme court on appeal, if, upon consideration of the record, such

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

court is of the opinion that such order was unlawful or unreasonable."

"Under the 'unlawful or unreasonable' standard specified in R. C. 4903.13, this court will not reverse or modify an opinion and order of the Public Utilities Commission where the record contains sufficient probative evidence to show that the commission's determination is not manifestly against the weight of the evidence and is not so clearly unsupported by the record as to show misapprehension, mistake or willful disregard of duty," *Columbus v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 103, 104. See, also, *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 108, 110; *Ohio Utilities Co. v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 153, 164; *Duff v. Pub. Util. Comm.* (1978), 56 Ohio St. 2d 367, 370; *General Motors Corp. v. Pub. Util. Comm.* (1976), 47 Ohio St. 2d 58, paragraph two of the syllabus; *Cleveland Electric Illuminating Co. v. Pub. Util. Comm.* (1975), 42 Ohio St. 2d 403, paragraph eight of the syllabus. We assess the appellants' objections with this standard of review in mind.

**I A.**

In its order the commission allowed approximately \$91 million to be included in the rate base for construction work in progress (CWIP) pursuant to R. C. 4909.15(A)(1) and 4909.15(E). R. C. 4909.15(A)(1) states in relevant part:

"\* \* \* The commission may, in its discretion, permit a reasonable allowance for construction work in progress but, in no event, may any allowance for construction work in progress be made by the commission until it is determined, after a physical inspection, that the particular construction project is a least seventy-five per cent complete."

R. C. 4909.15(E) imposes the following limitation on allowable CWIP:

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

"In no event shall an allowance for construction work in progress under division (A)(1) of this section exceed twenty per cent of the total valuation as stated in such division, not including such allowance."

Some \$90 million of the CWIP allowance was directly attributable to the Bruce Mansfield coal-fired generating station, which came on line several months after the new rates became effective. It is unquestioned that Bruce Mansfield met the 75 percent completion criterion for rate base eligibility pursuant to R. C. 4909.15(A)(1). Moreover, it is uncontroverted that inclusion of the Bruce Mansfield-related CWIP did not exceed the 20 percent of total valuation limitation imposed by R. C. 4909.15(E).

**I A(i).**

Appellants Senior Citizens Coalition et al. (hereinafter "SCC"), in case No. 80-1528, challenge the commission's allowance for CWIP in this case on the basis that the CWIP provisions contained in R. C. 4909.15(A)(1) represent an unconstitutional delegation of legislative power. Specifically, SCC contends that the statute "°°°°establishes no definite policy nor provides any standard for the exercise of PUCO discretion in permitting an allowance for construction work in progress and°°°°therefore the PUCO should be prohibited from granting any such allowance.°°°°"

We find no merit in SCC's constitutional challenge to the CWIP provisions because the commission's discretion is sufficiently circumscribed by the specific eligibility criteria enumerated in the statute. As we stated in *Consumers' Counsel v. Pub. Util. Comm.*, *supra* (58 Ohio St. 2d 108), at page 113:

"°°°°We believe these limitations adequately confine commission discretion. Further restriction would conceivably hinder the flexibility necessary to enable the com-

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

mission to carry out legislative will. For these reasons, this court holds that the discretion granted the commission under R. C. 4909.15 to authorize a reasonable allowance for construction work in progress in a utility's rate base constitutes a lawful delegation of the state's police power by the General Assembly."

We expressed the same view of the CWIP provisions of R. C. 4909.15(A)(1) in *Cleveland v. Public Util. Comm.* (1980), 63 Ohio St. 2d 62, 68. In the case at bar we decline to strike down the CWIP statute as an unconstitutional delegation of legislative authority.

I A(ii)

Both SCC and appellant City of Cleveland, in case No. 80-1547, contend that the inclusion of a CWIP allowance in this case constituted an abuse of commission discretion. As previously noted, the Bruce Mansfield generating station, which accounted for virtually all of the CWIP at issue, met the 75 percent completion criterion and came on line several months after the new rates went into effect. Under these circumstances, we cannot say that the commission's decision was either manifestly against the weight of the evidence or unsupported by the record. *Columbus vs. Pub. Util. Comm.*, *supra*. Therefore, we refuse to disturb the commission's findings on the propriety of including a CWIP allowance in CEI's rate base. Accordingly, we reject appellants' assertions that the commission abused its discretion in granting the CWIP allowance.

II.

SCC alleges that the commission did not adequately investigate CEI's generating capacity to determine whether the utility had excess capacity. The commission staff investigated CEI's generating capacity and determined that

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

the reserve capacity was adequate but not excessive.<sup>4</sup> Staff and CEI witnesses testified to the same effect at the hearings before the commission wherein they explained the methodology by which they reached their conclusions.

We have in a previous case acknowledged the difficulties the commission and utilities face on the excess capacity issue.

“\*\*\*Since utilities must anticipate load growth years in advance to maintain adequate capacity to ensure reliable service, it is unrealistic to expect a utility to have only the precise amount of capacity needed at a given time.” *Cleveland v. Pub. Util. Comm.*, *supra*, at 65. To paraphrase what we stated in *Consumers' Counsel v. Pub. Util. Comm.* (1980), 64 Ohio St. 2d 71, 79: Limited judicial review of an excess capacity determination is sound for the reason that while excess capacity analyses have an aura of precision about them, they are fraught with judgments and assumptions. Given the inherent problems of accurately projecting load growth, we are satisfied that the commission's excess capacity methodology is reasonable and that the factual findings are supported by the record. SCC's challenge on the question of excess capacity is, therefore, without merit.

**III A.**

Before proceeding to the merits of appellants' contentions on the question of whether the commission lawfully and reasonably treated the four cancelled nuclear power plants as amortizable costs, we must first consider two procedural issues raised by appellant Cleveland in case No. 80-1547. Cleveland first contends that CEI violated the

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<sup>4</sup> The record indicates that CEI had available 3,469 megawatts (MW) of capacity. The 1979 peak load was 3,097 MW and the forecasted 1980 peak load was 3,450 MW.

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

notice provisions of R. C. 4909.18 and 4909.19, R. C. 4909.18(E) requires that "[a] proposed notice for newspaper publication fully disclosing the substance of the application" must accompany the rate increase application. R. C. 4909.19 requires the applicant to publish in newspapers of general circulation the "substance and prayer of its application."<sup>8</sup> Cleveland asserts that CEI's proposed notice under R. C. 4909.18 and its published notice under R. C. 4909.19 were inadequate because no mention was made of the four terminated nuclear units in either notice.

Cleveland relies on *Committee Against MRT v. Pub. Util. Comm.* (1977), 52 Ohio St. 2d 231, and *Ohio Assn. of Realtors v. Pub. Util. Comm.* (1978), 60 Ohio St. 2d 172, to support its contention that CEI's statutory notices were inadequate. In *MRT*, *supra*, we stated, at page 233, that "•••a highly innovative and material change in the *method of charging* customers should be included in the notice." (Emphasis added.) The cancelled power plant information that Cleveland insists should have been included in the CEI notices herein complained of did not relate to an innovative method of charging that would profoundly affect the rates paid by certain categories of utility customers. Therefore, Cleveland's reliance on *MRT* and *Realtors* is misplaced.

The proposed notice under R. C. 4909.18(E) need only convey the "substance" of the application and the notice published pursuant to R.C. 4909.19 need only contain the "substance and prayer" of the application. The

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<sup>8</sup> Appellees challenge Cleveland's standing to complain of the allegedly flawed notices. The standing question, however, was not raised before the commission and, therefore, according to our well-settled rule, the issue is not properly before this court. *Stores Realty Co. v. Cleveland* (1975), 41 Ohio St. 2d 41, 43.

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

decision of the CAPCO companies to terminate the proposed plants did not alter the "substance" or the "substance and prayer" of CEI's application because CEI did not request additional rate relief when it revised its original application to reflect the terminated plant expenditures. We hold that the CEI notices met the standards of R. C. 4909.18 and 4909.19, and consequently Cleveland's assertions to the contrary are unfounded.

**III B.**

Cleveland's second procedural objection relates to the adequacy of the staff investigation and report in regard to the cancelled nuclear power plants. R. C. 4909.19 requires that the commission investigate and issue a report on rate increase applications. The commission did conduct an investigation and prepared a report on the original CEI application. As noted however, the initial commission staff report was silent on the subject of the terminated plants because the decision to cancel the plants was announced too late to be included in the report. However, the staff did subsequently investigate the matter of the terminated facilities and assessed the effect of the cancelled generating stations on CEI's pending rate application. Cleveland now complains that the omission of these matters from the original report and the tardy presentation of the staff review of the four terminated plants after hearings on the application had already begun were prejudicial and in violation of R. C. 4909.19. Cleveland asserts that "intervenor's have been consistently denied the opportunity to adequately prepare their case. They have [had] no opportunity to review the Staff's findings prior to hearings and thus no opportunity to prepare evidence to support or rebut the same."

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

Notwithstanding these contentions, Cleveland, after posing objections to the original report, did receive the benefits of the staff's investigation of the four terminated nuclear plants and had ample opportunity to cross-examine the commission's and CEI's experts at the public hearings. Cleveland did not seek additional time to prepare its case while these matters were pending before the commission. Moreover, Cleveland had already intervened in the case before the plant closing issue surfaced and therefore was not prejudiced by the omission of the cancelled plant data in the original report. *Worthington Hills Civic Assn. v. Pub. Util. Comm.* (1976), 45 Ohio St. 2d 11.

The purpose of the staff report is "to facilitate meaningful contest of rate increase applications by providing interested parties with the materials necessary for an informed challenge." *Duff v. Pub. Util. Comm.* (1978), 56 Ohio St. 2d 367, 376. The commission report in this case, as supplemented by the follow-up investigation conducted by the commission staff, provided appellant Cleveland with the opportunity to make an informed challenge. Therefore, the commission's investigation and report in the instant rate application case comply with the statutory requirements set forth in R. C. 4909.19.

**IV A.**

The core issue in each of these appeals is whether the commission lawfully and reasonably permitted CEI to treat its investment in the four cancelled nuclear generating stations as amortizable costs.

The commission order stated and analyzed the question in this fashion.

"What the company seeks is the recovery of costs incurred on behalf of its ratepayers to assure that adequate service could be maintained". The significant question,

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

given the Commission's past pronouncements with respect to the impropriety of the recovery of past losses through future rates, is whether the amortization of these extraordinary costs does violence to this principle. The distinguishing feature that sets this adjustment apart from those we have rejected on this ground in the past is that costs associated with the termination of the units did not really become costs until the fact of termination. Cancellation does not create a past loss, but gives rise to a current cost.<sup>\*\*\*</sup> [R]ejection of this adjustment would have a very direct impact on applicant's final performance as, in the absence of funding of the amortization through rates, applicant would be required to write off these costs currently<sup>\*\*\*</sup>. Thus, we now see the wisdom of the standard emerging from the cases from other jurisdictions; if the expenditures are prudent, amortization should be permitted.

"In determining whether these expenditures were prudent, one must bear in mind what is and what is not at issue. No one disputes that the 1973 decision to embark on the construction in question was reasonable as it was based on the best data available<sup>\*\*\*</sup>. Similarly, no one disputes that the decision to terminate construction was reasonable, given the intervening decline in growth expectations and the uncertainties which now attend the construction of nuclear units.<sup>\*\*\*</sup> The Commission finds that applicant's decisions were reasonable and prudent at every step of this process, and concludes that the proposed adjustment should be approved."

The appellants argue that the commission exceeded its authority and disregarded a carefully crafted statutory scheme when it acceded to CEI's request to amortize the cancelled nuclear plant expenditures.

There is no question but that the overwhelming weight of authority from other jurisdictions supports the

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

position of the commission.<sup>6</sup> In only two instances has amortization been disallowed.<sup>7</sup> It is important to note, however, that none of the previous rulings on this precise issue represents the opinion of the highest court of the jurisdiction in which the case arose. Virtually all of the decisions that the commission, CEI, and the *amici* cite in support of amortization derive from regulatory proceedings. Even more significant is the fact that no other case has considered the propriety of the commission's proposed amortization with reference to Ohio law. Thus, while counsel for the parties and intervenors before the court in this cause have thoroughly canvassed the administrative decisions in other jurisdictions and have supplied this court with copies of those decisions, we must regard these foreign regulatory opinions as advisory in nature. The construction of Ohio law is particularly the province of this court, and we are nowise bound by the pronouncements of regulatory regimes elsewhere in effect.

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<sup>6</sup> See, e.g., *Re San Diego Gas & Electric Co.* (Cal. Pub. Util. Comm. 1979), 29 P.U.R. 4th 613; *Re Potomac Electric Power Co.* (Md. Pub. Ser. Comm. 1977), Order No. 6999; *Re Consumer Power Co.* (Mich. Pub. Ser. Comm. 1975), Case No. F-700; *Re Northern States Power Co.* (Minn. Pub. Ser. Comm. 1977), Dkt. E-0021 GR-76-934; *Re Public Service Electric and Gas Co.* (N.J. Dept. of Energy, Bd. of Pub. Util. 1980), Dkt. No. 794-310; *Re Consolidated Edison Co. of New York* (N.Y. Pub. Ser. Comm. ), Case No. 9187; *Re Carolina Power & Light Co.* (N.C. Util. Comm. 1979), Dkt. No. E-2, Sub. 352; *Re Gulf States Utilities Co.* (Pub. Util. Comm. of Texas 1979), Dkt. No. 2677; *Re Virginia Electric & Power Co.* (Va. Corp. Comm. 1979), 29 P.U.R. 4th 65; *Re Wisconsin Electric Power Co.* (Pub. Ser. Comm. of Wis. 1980), Case No. 05-C1-3; *Re Potomac Electric Power Co.* (D.C. Pub. Ser. Comm. 1979), 29 P.U.R. 4th 517.

<sup>7</sup> See *Re Arizona Public Service Co.* (Ariz. Corp. Comm. 1980), Decision No. 51009; *Re Northern States Power Co.* (Pub. Ser. Comm. of N.D. 1980), Case No. 10,097.

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

**IV B.**

The commission's approval of amortization was predicated on the prudence of CEI's original decision to build the nuclear facilities and the subsequent decision to cancel the plants. We must decide whether the test of prudence, as applied by the commission, which supports treating the expenditures associated with the terminated nuclear generating stations as amortizable costs, is consistent with the statutorily mandated ratemaking formula contained in R. C. 4909.15.

**IV B(i).**

The controversy surrounding the cancelled nuclear power plants focuses primarily on R. C. 4909.15(A)(4), which delineates the service-related costs that a utility may recover from its ratepayers. This section states in relevant part:

"The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges shall determine:

"..."

"(4) The cost to the utility of rendering the public utility service for the test period"""

The commission urges that "an expenditure by a utility can be considered a cost of rendering the public utility service if it fails in fact to achieve its intended purpose"" [if] the expense was reasonably calculated to provide [future] utility service at a reasonable cost." The underpinnings for the commission rationale may be found in those statutory provisions that require utilities to maintain adequate service presently and for the foreseeable future. See, *e.g.*, R. C. 4905.22 (adequate service and facilities).

Notwithstanding the provisions that impose a duty on utility companies to plan for the future, the question under

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

R. C. 4909.15(A)(4) remains whether the cancelled plant expenditures represent "[t]he cost to the utility of rendering the public utility service for the test period." Test period considerations aside, what the company sought and what the commission granted was the amortization as service-related costs of an investment that never provided any service whatsoever to the utility's customers.

We seriously question whether the General Assembly contemplated that the commission would treat the type of expenditures controverted herein as costs under R. C. 4909.15(A)(4). The now terminated nuclear plants represented a major capital investment that ultimately would have been included in the rate base under R. C. 4909.15(A)(1), had the projects not been cancelled. It is our opinion that R. C. 4909.15(A)(4) is designed to take into account the normal, recurring expenses incurred by utilities in the course of rendering service to the public for the test period.<sup>8</sup> A non-exhaustive list of such expenses would include reasonable expenditures for repairs, maintenance, personnel-related costs, administrative expenses, and taxes.

The extraordinary loss sustained by CEI in connection with the terminated nuclear plants cannot be transformed into an ordinary operating expense pursuant to R. C. 4909.15(A)(4) by commission fiat. The commission's statement that "[c]ancellation does not create a past loss, but gives rise to a current cost" is unpersuasive. Under this rationale we question whether there could ever be a "past loss" the return of which would not be recoverable in future ratemaking proceedings notwithstanding the com-

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<sup>8</sup> Appellants contend that the "direct, primary benefit" test enunciated in *Cleveland v. Pub. Util. Comm.* (63 Ohio St. 2d 62), *supra*, is applicable to the case at bar. We disagree. The direct, primary benefit standard should not be wrenched from the institutional advertising expenses and charitable contributions context in which it arose.

**Consumers' Counsel v. Pub. Util. Comm.**  
**67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)**

**Opinion, per SWEENEY, J.**

mission's assertion to the contrary. The commission's characterization of the investment in the four terminated plants as "cost" under R. C. 4909.15(A)(4) in light of what we perceive to be the legislative intention underlying that section is unreasonable. Therefore, to the extent that the commission's order in regard to the cancelled plants is predicated on R. C. 4909.15(A)(4), the order cannot stand.

**IV B(ii).**

The commission and CEI also argue that even if, as we have found, R. C. 4909.15(A)(4) is inapplicable, then under R. C. 4909.15(D)(2)(b) the commission may authorize the amortization of the investment in the terminated nuclear facilities.

R. C. 4909.15 states in relevant part:

"(D) When the public utilities commission is of the opinion, after hearing and after making the determinations under divisions (A) and (B) of this section\*\*\*that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable, the commission shall:

"\* \* \*

"(2) With due regard to all such other matters as are proper, according to the facts in each case,

"\* \* \*

"(b)\*\*\*fix and determine the just and reasonable rate, fare, charge, toll, rental, or service to be rendered, charged, demanded, exacted, or collected for the performance or rendition of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one.\* \* \*

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

For purposes of R. C. 4909.15(D)(2)(b) the question presented is whether the cancelled nuclear power plant costs fall under the "all such matters as are proper" language of the statute. The commission views R. C. 4909.15(D)(2)(b) as a virtual wild card to be played whenever the commission in its discretion sees fit. We interpret the statute less sweepingly, first because the provisions are linked inextricably with the ratemaking factors contained in R. C. 4909.15(A) and (B), and secondly because the General Assembly undoubtedly did not intend to build into its recently revised (1976) ratemaking formula a means by which the commission may effortlessly abrogate that very formula.

To be a proper matter giving rise to a permissible adjustment under R. C. 4909.15(D)(2)(b), the matter in question must relate to factors otherwise included in R. C. 4909.15. R. C. 4909.15(D)(2)(b) makes reference to "the allowable *gross* annual revenues under division (B)." (Emphasis added.) Having previously determined that the nuclear plant costs are not properly includable under R. C. 4909.15(A), then these costs can have no effect on the gross annual revenue determination under R. C. 4909.15(B). Therefore, we reject the commission's argument invoking R. C. 4909.15(D)(2)(b) as alternative statutory authority for its order granting CEI permission to amortize its investment in the cancelled nuclear facilities.

It is our view that R. C. 4909.15(D)(2)(b) is designed to allow the commission to make minor adjustments to rates ascertained by the statutory formula when the criteria upon which the rates are based are skewed for one reason or another. Thus, under R. C. 4909.15(D)(2)(b), the commission may smooth out anomalies in the rate-making equation that tend to make the test year data unrepresentative for ratemaking purposes.

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

**IV B (iii)**

"[T]his court has consistently recognized that the Public Utilities Commission is a creature of the General Assembly and may exercise no jurisdiction beyond that conferred by statute." *Dayton Communications Corp. v. Pub. Util. Comm.* (1980), 64 Ohio St. 2d 302, 307. See, also, *Werlin Corp. v. Pub. Util. Comm.* (1978), 53 Ohio St. 2d 76, 80; *Ohio Public Interest Group v. Pub. Util. Comm.* (1975), 43 Ohio St. 2d 175, 176, paragraph five of the syllabus; *Penn Central Transportation Co. v. Pub. Util. Comm.* (1973), 35 Ohio St. 2d 97, paragraph one of the syllabus. Stated differently, the commission may not legislate in its own right. This, however, is what the commission has attempted to accomplish in the case at bar.

The commission order engrafts upon the statutory rate-making scheme an exception that would allow utility companies to recover their investment in unfinished projects ineligible for rate base treatment if the original decision to build the facilities and the subsequent decision to cancel the projects are prudent under the circumstances. In so doing the commission has exceeded its statutory mandate. We hold that the commission unreasonably and unlawfully exceeded its statutory authority when it approved amortization of CEI's investment in the four terminated nuclear power plants.

**IV C.**

Appellants contend that the commission also erred in including the cancelled plant costs in the calendar year 1979 test period because the termination was not announced until January 23, 1980. Inasmuch as we have already determined that the commission improperly allowed amortization of the utility's investment in the terminated nuclear facilities, it is unnecessary for us to address the timing issue raised in this cause.

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

**IV D.**

We are mindful of the policy considerations that prompted the commission's decision. The commission, CEI, and the *amici* argue strenuously that to rule as we have today will seriously disadvantage Ohio utilities in capital markets thereby "driv[ing] up the return on investment required by investors in Ohio utilities." This gloomy scenario, however, does not imbue the commission with the authority to rewrite the statutes. The statutes in question contain no provisions insulating investors from the type of losses sustained in the cancelled-plants venture.

If, as has been argued, these are parlous times for the utilities industry, and if, therefore, in order to attract and retain investment capital, utility companies must not only be granted a fair and reasonable rate of return pursuant to statute but must also be assured the return of capital invested in failed projects that would otherwise not be recoverable under the ratemaking formula, then the commission and the utilities should petition the General Assembly to enact changes in the ratemaking structure so as to provide this extra modicum of protection for the investors. Absent such explicit statutory authorization, however, the commission may not benefit the investors by guaranteeing the full return of their capital at the expense of the ratepayers. Under the ratemaking formula now in effect consumers are not chargeable for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs. What we previously stated in a rate base case is applicable to the case at bar: "\*\*\*It is only proper that their [the investors] venture be found operational before they commence to recoup their capital outlays from the consumers." *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 449, 456-457.

**Consumers' Counsel v. Pub. Util. Comm.**  
67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Opinion, per SWEENEY, J.**

We take a dimmer view of the second policy argument advanced by the commission to support its order. The commission suggests that if the appellants prevail on this issue, then "[r]ather than prudently cancel certain projects, it is not inconceivable that at least some utility managements would complete expenditures on a project and have ratepayers pay a return on dollars which would have more wisely not been spent." R. C. 4909.154 specifically empowers the commission to investigate management policies, practices and organization to determine whether a public utility is properly managed. If a utility completes a project that should have been abandoned, then the commission must under the "used and useful" requirement of R. C. 4909.15(A)(1) disallow rate base treatment and under R. C. 4909.154 disallow any claimed operating expenses related to the unnecessary project. We are confident that if any utility managers who might be tempted to act as the commission suggests are aware that the commission, pursuant to its statutory responsibilities, is vigorously scrutinizing all proposed and in-progress construction projects, these managers will decide whether or not to abandon a particular project according to their best and most prudent business judgment. Thus, we reject the commission's argument that our decision today may engender imprudent decision making in utility company boardrooms.

For reasons hereinbefore stated the order of the commission is affirmed in part and reversed in part, and this cause is remanded to the commission for a redetermination of CEI's allowable operating expenses, excluding therefrom the expenditures attributable to the cancelled nuclear facilities.

*Order reversed in part and  
affirmed in part.*

**Consumers' Counsel v. Pub. Util. Comm.**  
**67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)**

**Concurring and Dissenting Opinion, per P. BROWN, J.**

CELEBREZZE, C. J., W. BROWN and C. BROWN, JJ.,  
 concur.

P. BROWN, LOCHER and HOLMES, JJ., concur in part  
 and dissent in part.

PAUL W. BROWN, J., concurring in part and dissenting  
 in part.

I concur in Parts I, II and III of the majority opinion  
 insofar as they affirm the commission's decision to allow  
 rate base treatment for CWIP attributable to the Bruce  
 Mansfield coal-fired generating station. I dissent, however  
 from Part IV of the opinion.

In Part IV of its opinion, the majority reverses the  
 commission's decision to allow amortization of the costs  
 incident to termination of the four nuclear facilities in  
 question. In so doing, the majority does not disturb the  
 commission's findings that CEI acted both prudently and  
 reasonably in incurring these costs. Instead, the majority  
 holds that it was not the intent of the General Assembly to  
 treat expenditures of this type as "costs" within the mean-  
 ing of R. C. 4909.15(A)(4). I believe the majority's inter-  
 pretation of this section to be too restrictive.

The term "cost" is not defined in R. C. Chapter 4909.  
 Therefore, it is necessary to look elsewhere to ascertain the  
 meaning of this word. In 1961, the commission adopted  
 standard accounting procedures to be used by Ohio utili-  
 ties. "The system of accounts and records identified and  
 designated as 'Uniform System of Accounts Prescribed for  
 Public Utilities and Licensees effective January 1, 1961'  
 \* \* \* is adopted by this Commission \* \* \*." Ohio Adm.  
 Code 4901:1-9-05. This "Uniform System of Accounts" was  
 promulgated in 18 C.F.R., Part 101.

An analysis of this uniform system clearly demon-  
 strates that expenditures such as those incurred in the  
 termination of the four nuclear generating units were in-

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Concurring and Dissenting Opinion, per P. BROWN, J.**

tended to fall within the statutory definition of "costs." The uniform system states, in part:

"182 Extraordinary property losses.

"A. \* \* \* this account shall include extraordinary losses on property *abandoned* or otherwise retired from service which are not provided for by the accumulated provisions for depreciation or amortization and which could not reasonably have been foreseen and provided for \* \* \*." (Emphasis added.) *Id.*, at 324.

"407 Amortization of property losses.

"This account shall be charged with amounts credited to account 182\* \* \*." *Id.*, at 356.

This accounting system has been in effect in Ohio for approximately two decades. Given this fact, we can reasonably assume that the General Assembly was cognizant of its existence when it amended R. C. 4909.15 in 1976, and that it was not the intent of the General Assembly to treat these extraordinary property losses in a different manner in which they were treated by the Public Utilities Commission.

Moreover, as the majority correctly notes, "the overwhelming weight of authority from other jurisdictions supports the position of the commission." The majority dismisses this significant point with the facile statement that none of the cases from these other jurisdictions represents the opinion of the highest court of the jurisdiction; nor, has any other jurisdiction construed or applied Ohio law in reaching its determination. While I do not assert that decisions from other jurisdictions are controlling in Ohio, I cannot accept the majority's summary disposition of these foreign decisions. First, this court, in the past, has recognized the persuasive value of decisions from other jurisdictions in this area. See *Ohio Water Service Co. v. Pub. Util. Comm.* (1980), 64 Ohio St. 2nd 12. Second, the

**Consumers' Counsel v. Pub. Util. Comm.**  
 67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)

**Concurring and Dissenting Opinion, per P. BROWN, J.**

near unanimity of decisions from other jurisdictions allowing amortization of these types of expenditures further demonstrates the reasonableness of the commission's decision in this case.

Appellants urged before this court that before any expense or cost could be passed on to the ratepayers, it must confer a direct and primary benefit upon said ratepayers. Implicit in the majority's decision is an acceptance of this argument. Thus, the majority, today, takes another step toward entrenching the spurious "direct, primary benefit" test into the public utilities law of Ohio.<sup>9</sup>

"Review of orders of the Public Utilities Commission on appeal is limited to a consideration of whether the order is unreasonable or unlawful<sup>9</sup>." *Cremean v. Pub. Util. Comm.* (1976), 48 Ohio St. 2d 163, paragraph one of the syllabus. The order in the instant cause is neither unreasonable nor unlawful. Accordingly, I would affirm the decision of the commission in its entirety.

HOLMES, J., concurs in the foregoing concurring and dissenting opinion.

LOCHER, J., concurring in part and dissenting in part. I concur in the syllabus and Parts III (notice and staff investigation) and IV (amortization) of the majority opinion. I would also note, however, that the financial effect of this decision on CEI will be insignificant. CEI informed its investors in its "1979 Annual Report": "••• The Company [CEI] will seek the approval of the Federal Energy Regulatory Commission and The Public Utilities Commission of Ohio for authority to amortize [the costs previously expended toward the four nuclear units whose construction CAPCO terminated] over a suitable number

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<sup>9</sup> See Justice Herbert's dissent in *Cleveland v. Pub. Util. Comm.* (1980), 63 Ohio St. 2d 62, 75, in which I concurred.

**Consumers' Counsel v. Pub. Util. Comm.**  
**67 Ohio St. 2d 153, 423 N.E. 2d 820 (1981)**

**Concurring and Dissenting Opinion, per P. BROWN, J.**

of years. The extent to which these costs may be recovered through rates will be determined by the PUCO. If any costs of termination are not permitted to be recovered, the Company would be required to reduce Net Income by the disallowed amount. In any event, the resolution of these matters should not have a material adverse impact on the financial position of the Company."

I dissent from Part I of the majority opinion (CWIP), because PUCO refuses to define standards for review of CWIP matters. My dissenting opinions in *Consumers' Counsel v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 108, 117, and *Consumers' Counsel v. Pub. Util. Comm.* (1981), 66 Ohio St. 2d 162, 167, express the reasons for my concern.

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company for Authority to Amend and  
Increase Certain of its Filed Sched-  
ules Fixing Rates and Charges for  
Electric Service.

**Case No.  
79-537-EL-AIR**

In the Matter of the Complaint and  
Appeal of The Cleveland Electric  
Illuminating Company from Ordinance No. 1673-79 of the Council of  
the City of Cleveland, Ohio Passed  
August 7, 1979, entitled "An Ordinance  
Setting the Maximum Rates  
which may be Charged by The  
Cleveland Electric Illuminating  
Company for Electric Service Within  
the City of Cleveland."

**Case No.  
79-774-EL-CMR**

**REHEARING ENTRY**

The Commission, coming now to consider the above-entitled matters, and, specifically, its opinion and Orders in these dockets of July 10, 1980, and its applications for rehearing filed by the applicant and other participating parties, hereby makes the following findings.

- 1) On July 10, 1980, the Commission issued its Opinion and Order in these dockets granting, in part, the application of the Cleveland Electric Illuminating Company for authority to increase its rates and charges for electric service rendered jurisdictional customers, and sustaining the com-

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

pany's complaint that Ordinance No. 1673-79 of the City of Cleveland was unjust and unreasonable.

- 2) Rehearing applications were timely filed pursuant to the provisions of Section 4903.10 Revised Code by the applicant, the City of Cleveland, the Office of Consumers' Counsel, Senior Citizens, *et al.*, and the Industrial Electricity Consumers.
- 3) Through its rehearing application, the Illuminating Company alleges that the Commission's July 10, 1980 Opinion and Order is unreasonable and unlawful in some 39 particulars. Review of these assignments of error indicates that the majority represent nothing more than a restatement of the company's original objections relative to those issues which have now been decided adversely to the applicant. The Commission is of the opinion that these claims were adequately considered in the order now complained of with the exception of three of the issues which the applicant elected to address in the memorandum accompanying its rehearing application.
- 4) By its twenty-fourth assignment of error, applicant alleges that the Commission unreasonably refused to adjust test-year labor expense to recognize wage increases which became effective subsequent to the test period. In considering this ground for rehearing, the Commission must first point out that adjustments for out-of-period cost changes, while accepted in some instances where strict conditions are satisfied, are the exception rather than the rule. If the test-year concept is to remain a viable basis for determining cost of service, a matching of revenues and expenses must be maintained. The Commission has departed from this principle in only the most compelling circumstances as, for example, in cases where we are confronted with a very remote test

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

year (*Columbia Gas of Ohio*, Case No. 77-1309-GA-AIR [May 24, 1979]). Applicant argues that the adjustment proposed in this proceeding does satisfy the conditions discussed in prior Commission orders, specifically *East Ohio Gas Company*, Case No. 79-535-GA-AIR (July 9, 1980). As the Commission has granted rehearing on this issue in the *East Ohio* case (*East Ohio Gas Company*, *supra*, Entry on Rehearing, August 7, 1980) we believe the matter deserving of further consideration in these dockets as well. Rehearing on this ground should be granted.

- 5) Through the twenty-eighth ground advanced by the company as a basis for rehearing, applicant contends that the Commission erred in excluding certain advertising costs from allowable expenses without evidence as to whether the advertisements in question benefited the customers. As the Commission found in the order now complained of, these advertisements appeared to be solely promotional in character. However, on the day preceeding the issuance of the Opinion and Order, the Supreme Court of Ohio handed down its decision in *Cleveland v. Public Utilities Commission*, 63 Ohio St. 2d 62 (1980), whereby a new test for the eligibility of advertising expenses was apparently established. As the Commission will herein grant the rehearing sought by certain other participants with respect to the advertising question in light of this development, we deem it appropriate to also permit the company to participate in our efforts to interpret the import of the Court's decision. We, therefore, find the application for rehearing on this ground to be well made and hereby grant rehearing on this issue.
- 6) By its twenty-ninth assignment of error, applicant charges that the Commission acted unreasonably in failing to include any allowance for charitable contributions in the cost of service

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

determination. In the Commission's view, this result, which was a departure from previous Commission practice, was mandated by the Court's decision in *Cleveland v. Public Utilities Commission*, *supra*. Applicant argues that the language of the Court's decision will admit of other interpretations, a view which the Commission believes the company should be entitled to pursue through argument and the presentation of additional evidence. Rehearing should be granted for this purpose.

- 7) Rehearing should be denied with respect to all other grounds set out by applicant.
- 8) The City of Cleveland charges that the Commission's Opinion and Order of July 10, 1980 is unreasonable and unlawful in a number of particulars. Those grounds relating to the issues of the used and useful nature of Davis-Besse, excess capacity, construction work in progress, terminated generating units, rate case expense, legal fees, and tariff matters were all adequately addressed in the Commission's original opinion and no further discussion is necessary. Rehearing on these grounds should be denied. Some response is required, however, to the City of Cleveland's assertion that the Commission could not properly find that the rates contained in Ordinance No. 1673-79 of the City of Cleveland from which the complaint and appeal in Case No. 79-774-EL-CMR was taken were unreasonable.
- 9) Review of the record clearly indicates that the Commission did allocate property, revenues, and expenses between the ordinance area and the balance of the company's service territory and that it did so based on evidence presented by the staff (S.R., pp. 4-6; 162-163). The fact that the City of Cleveland chose not to inquire of the staff witness on this subject does not mean that those allocations were unsupported. The or-

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

dinance rates were quite clearly unjust and unreasonable in that they generated revenues which were grossly insufficient to provide the company reasonable compensation for the service rendered affected customers. Further, the City's arguments relative to interclass allocations reveal a basic misapprehension of the class responsibility methodology employed by the company. We commend Applicant's Exhibit Nos. 6, 9 and 1 (Sched. B-6 and Sched. C-4) to the City's attention. Rehearing on this ground should be denied.

- 10) Consistent with our above discussion, the City of Cleveland's application for rehearing on the issue of advertising expenses should be granted.
- 11) The Office of Consumers' Counsel assigns as error only the Commission's determination that the costs associated with the termination of four nuclear generating units should be included in the cost of service in these proceedings. No arguments have been advanced which have not adequately been addressed in the Commission's Opinion and Order and rehearing on this ground should be denied.
- 12) Intervenor Senior Citizens, *et al.*, seeks rehearing on the question of the inclusion of Davis-Besse in rate base, excess capacity, construction work in progress, cash working capital, terminated nuclear units, and certain tariff matters. The Commission is of the opinion that these matters have been adequately discussed in the order now complained of and finds that rehearing on these grounds should be denied. In keeping with our earlier findings, Senior Citizens' application for rehearing with respect to the issue of advertising expense should be granted.
- 13) The rehearing application filed by the intervening Industrial Electricity Consumers is actually taken from the Commission's Entry of July 14,

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

1980 in this docket whereby the Commission accepted applicant's new tariffs for filing. Intervenor's contend that this Entry contains the erroneous finding that the tariffs, as submitted, conformed to the Commission's July 10, 1980 Opinion and Order. Specifically, intervenors charge that the Industrial and Large Industrial rate schedules approved (PUCO No. 11, 6th Rev. Sheet No. 26 and PUCO No. 11, 6th Rev. Sheet No. 28) are not consistent with the Commission's directive concerning the adjustments to the proposed tariffs necessary to reflect the fact that the revenue increase authorized was somewhat less than that originally requested by the company.

- 14) In the July 10, 1980 Opinion and Order, the Commission did not specifically set out the method to be employed in adjusting the tariffs. The Commission found only that the staff tariff recommendations which were not subject to specific objection should be implemented. Among those recommendations was the staff suggestion that if the rate relief authorized was less than that requested, the reductions in the various rate schedules should be performed so as to retain the proportionality between the various blocks (S.R., p. 56). The applicant also supported this technique (Tr. XX, pp. 55-56) which, it might be noted, represents the approach customarily followed by the Commission under such circumstances (See e.g. *Dayton Power and Light*, Case No. 79-510-EL-AIR [July 31, 1980]).
- 15) The Commission agrees with the Industrial Electricity Consumers that the Industrial and Large Industrial rate sheets submitted by the applicant and accepted by the Commission's July 14, 1980 Entry reflected no downward adjustment to the original base energy portions of the rate structures as originally proposed. However, the impact of the failure of the company to adjust all portions of these rates is so slight (actually less than a

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

fraction of a percent) that the Commission does not believe that the basic proportionality of the rates has been meaningfully altered. The new schedules, as filed, reasonably satisfied the Commission's intent and the Entry approving these schedules should be affirmed. The rehearing application of the intervening Industrial Electricity Consumers should be denied.

It is, therefore,

ORDERED, That the rehearing application filed August 8, 1980, by the Cleveland Electric Illuminating Company be, and hereby is granted to the extent provided above and denied in all other respects. It is, further,

ORDERED, That the rehearing application filed August 11, 1980, by the City of Cleveland be, and hereby is granted to the extent provided above and denied in all other respects. It is, further,

ORDERED, That the rehearing application filed August 8, 1980, by the Office of Consumers' Counsel be, and hereby is denied. It is, further,

ORDERED, That the rehearing application filed August 8, 1980, by Senior Citizens, *et al.*, be, and hereby is granted to the extent provided above and denied in all other respects. It is, further,

ORDERED, That the rehearing application filed August 7, 1980, by the Industrial Electricity Consumers, be and hereby is denied. It is, further,

ORDERED, That the rehearing granted to consider the issues identified above be, and hereby is scheduled to commence at 9:30 A.M. on Wednesday, October 8, 1980, at the offices of the Commission, 375 South High Street, Columbus, Ohio. It is, further,

**Rehearing Entry, PUCO Case No. 79-537-EL-AIR**

ORDERED, That copies of this Entry be served upon all parties of record.

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

/s/ WILLIAM NEWCOMB

(Chairman)

/s/ STEPHEN A. REILLY

/s/ MICHAEL DELBANE

(Commissioners)

Entered in the Journal  
Sept. 3, 1980

A True Copy

DAVID M. POLK

David M. Polk  
Secretary

**Opinion and Order of the  
Public Utilities Commission of Ohio**

**(Filed July 10, 1980)**

**BEFORE**

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of  
The Cleveland Electric Illuminating  
Company for Authority to Amend  
and Increase Certain of its Filed  
Schedules Fixing Rates and Charges  
for Electric Service.

**Case No.  
79-537-EL-AIR**

In the Matter of the Complaint and  
Appeal of The Cleveland Electric  
Illuminating Company from Ordinance No. 1673-79 of the Council of  
the City of Cleveland, Ohio Passed  
August 7, 1979, entitled "An Ordinance Setting the Maximum Rates  
which may be Charged by The Cleveland Electric Illuminating Company  
for Electric Service Within the City  
of Cleveland".

**Case No.  
79-774-EL-CMR**

**OPINION AND ORDER**

The Commission, coming now to consider the above-entitled permanent rate application filed by the Cleveland Electric Illuminating Company pursuant to Section 4909.18 Revised Code and the above-styled complaint and appeal filed by the Cleveland Electric Illuminating Company pursuant to Section 4909.34 Revised Code; the Staff Report

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

of Investigation issued pursuant to Section 4909.19 Revised Code; having appointed its attorney examiner, Barth E. Royer, pursuant to Section 4901.18 Revised Code to conduct a public hearing and to certify the record thereof directly to the Commission; the testimony and exhibits introduced into evidence at the public hearing commencing April 2, 1980, and concluding May 22, 1980; its prior Entries and Orders in these dockets; and being otherwise fully advised in the premises and in compliance with Section 4903.09 Revised Code, hereby issues its Opinion and Order.

**History of the Proceedings:**

The Cleveland Electric Illuminating Company, the applicant herein, is an Ohio corporation engaged in the business of supplying electric service in this state. The company provides retail service to some 699,000 customers in a 1,700 square mile service territory which encompasses the greater Cleveland area as well as all or parts of nine northeastern Ohio counties. As a public utility and an electric light company within the definitions of Sections 4905.02 and 4905.03(A)(4) Revised Code, applicant is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06 Revised Code. The company's present rates for electric service were established by the May 2, 1979 Opinion and Order of this Commission in Case No. 78-677-EL-AIR, as subsequently modified by the Order on Rehearing in that docket of March 5, 1980.

On June 19, 1979, the Cleveland Electric Illuminating Company served and filed a notice of its intent to submit a permanent rate increase application pursuant to Section 4909.18 Revised Code as required by Section 4909.43(B) Revised Code and Rule 4901-1-36 Ohio Administrative Code. As a part of this prefiling notification, applicant re-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

quested that June 30, 1979, be fixed as the date certain for the valuation of property and that the twelve months ending December 31, 1979 be established as the test period for the analysis of accounts. The Commission approved the proposed date certain and test year by Entry of July 5, 1979. By motion of August 3, 1979, applicant requested a waiver of certain of the Commission's Standard Filing Requirements. This motion was granted in part and denied in part by Commission Entry of August 22, 1979. The application itself was filed September 17, 1979. The Commission accepted the application for filing by Entry of October 19, 1979, and approved the proposed form of the required legal notice subject to certain modifications.

On August 7, 1979, the Council of the City of Cleveland passed Ordinance No. 1673-79, which continued in effect the Illuminating Company's existing rates for service within that municipality for a two-year period commencing June 19, 1980. The company filed a complaint and appeal from said ordinance pursuant to the provisions of Section 4909.34 Revised Code on August 31, 1979. By Entry of September 26, 1979, the Commission determined that the evaluation of the complaint and appeal should be conducted with reference to the same date certain and test year previously approved in connection with the pending general rate application and that the two cases should be consolidated. The company submitted the information required by the Standard Filing Requirements on November 19, 1979, and the Commission, by Entry of December 12, 1979, accepted the complaint and appeal for filing as of that date. An amended proposed form of legal notice was approved for publication.

By its Entry of August 8, 1979, in Case No. 79-525-EL-ATA, the Commission approved the application of the Cleveland Electric Illuminating Company for authority to establish rates and terms and conditions of service for electric street lighting service. Proposed tariff sheets gov-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

erning this service were accepted for filing pursuant to Section 4909.18 Revised Code as an application not for an increase in rates. However, in its Entry of October 5, 1979, issued in response to rehearing applications filed by certain affected municipalities, the Commission concluded that a rehearing should be granted for the purpose of reviewing the reasonableness of the new street lighting tariffs. The Commission directed that this matter be consolidated for hearing with the pending rate case.

In accordance with the provisions of Section 4909.19 Revised Code, the Staff of the Commission conducted an investigation of the matters set forth in the application and the complaint and appeal. A written report of the results of the staff investigation was filed March 4, 1980, and was served as provided by law. Objections to the Staff Report were timely filed by the applicant and by the following intervenors: the Office of Consumers' Counsel; the City of Cleveland, Senior Citizens, *et. al.*; Industrial Electricity Consumers; and the City of University Heights.

Pursuant to the Commission's Entry of March 12, 1980, the public hearing of these matters commenced April 2, 1980, before attorney examiner Barth E. Royer. The first day of hearing was held at City Hall in Cleveland, Ohio, to afford members of the public affected by these cases the opportunity to present statements concerning the proposed increase. Subsequent sessions were held at the offices of the Commission, 180 East Broad Street, Columbus, Ohio. The recorded transcript of the proceeding and the exhibits admitted into evidence during the 32 days of hearing have now been certified to the Commission by the examiner for its consideration.

**Appearances:**

Mr. Alan D. Wright, General Counsel, and Mr. Craig I. Smith, Senior Counsel, 55 Public Square, Cleveland, Ohio; and Messrs. Squire, Sanders & Dempsey, by Messrs.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Alan P. Buchmann, Lowell L. Garret, William C. Donahue, and Richard W. McLaren, Jr., 1800 Union Commerce Building, Cleveland, Ohio, on behalf of the applicant, the Cleveland Electric Illuminating Company.

Mr. William J. Brown, Attorney General of Ohio, by Messrs. Thomas L. Mumaw, David Neubauer, and James Bacha and Ms. Judith B. Sanders, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio, on behalf of the Staff of the Public Utilities Commission of Ohio.

Mr. James E. Wagner, Director of Law, and Mr. James L. Harkins, Jr., Assistant Director of Law, Cleveland City Hall, 601 Lakeside Avenue, Cleveland, Ohio; and Mr. Henry W. Eckhart, 88 East Broad Street, Columbus, Ohio; on behalf of the City of Cleveland, Ohio.

Mr. William A. Spratley, Consumers' Counsel, by Mr. Gary M. Petroff and Ms. Gretchen J. Hummel, Associate Consumers' Counsel, 137 East State Street, Columbus, Ohio, on behalf of the Office of Consumers' Counsel.

Mr. Joseph P. Meissner, Cleveland Legal Aid Society, 1223 West 6th Street, Cleveland, Ohio, on behalf of the Senior Citizens Coalition, the Cleveland Welfare Rights Organization, Inc., the Western Reserve Alliance, the Cleveland Chapter of Ohioans for Utility Reform, and North Shore Alert, intervenors.

Messrs. Bell & Clevenger, L.P.A., by Messrs. Langdon D. Bell, and Samuel C. Randazzo, 21 East State Street, Columbus, Ohio, on behalf of Industrial Electricity Consumers (Aluminum Corporation of America, Chase Brass and Copper Company, Inc., General Motors Corporation, Jones and Laughlin Steel Corporation, Olin Corporation, and Union Carbide Corporation), intervenors.

Mr. Guerin L. Avery, Law Director, Brainard Place-Suite 333, 29001 Cedar Road, Lyndhurst, Ohio, on behalf of the City of University Heights, Ohio, intervenor.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR****Commission Review and Discussion:**

These cases come before the Commission upon the application of the Cleveland Electric Illuminating Company pursuant to Section 4909.18 Revised Code for authority to increase its rates and charges for electric service to its jurisdictional customers and upon the company's complaint and appeal pursuant to Section 4909.34 Revised Code from Ordinance No. 1673-79 of the City of Cleveland, Ohio, whereby it is charged that said ordinance, which would continue applicant's present rates in effect, is unreasonable and unlawful. Applicant alleges that its existing rates are insufficient to provide it reasonable compensation for the service it renders customers affected by these proceedings and seeks Commission approval of rate schedules which would yield some \$79,795,000 in additional gross annual revenues based on its analysis of test-year operations. This additional revenue represents an increase of approximately 10.3 percent over that currently realized from service to jurisdictional customers. It now falls to the Commission to evaluate the evidence of record in order to determine if applicant's existing jurisdictional rates are inadequate and if the ordinance appealed from is unreasonable. In the event applicant is found to have sustained its burden of proof with respect to these matters, the Commission must then establish rates which will afford the company the opportunity to earn a fair rate of return.

Also before the Commission for consideration at this time is Case No. 79-525-EL-ATA, an application by Cleveland Electric Illuminating Company to establish rates and terms and conditions of service for providing electric street lighting within its service territory. Although the Commission has previously accepted this tariff as an application not for an increase in rates by its entry in this docket of August 8, 1979, specific provision was made in

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

its rehearing entry of October 5, 1979, for a review of the reasonableness of the rates contained therein in the context of the pending rate proceedings. We will address the street lighting matter through a separate opinion.

**JURISDICTIONAL ALLOCATIONS**

In assigning rate base and demand-related expenses to the customers affected by the instant application and complaint and appeal, the applicant generally followed the two-peak allocation methodology accepted by the Commission in its prior case (App. Ex. 6B, p. 8). However, in developing the allocation factors to be used for purposes of these proceedings, the company used a projected summer and winter peak rather than relying on historical data for determining weighted seasonal peak demands. Further, applicant also adjusted the power plant capacity ratios to reflect an anticipated decline in non-jurisdictional load levels resulting from a reduction in contract demand associated with service to the Cleveland Department of Public Utilities (App. Ex. 6B, pp. 2-3). The staff recommends that these allocation procedures be rejected and proposes, in lieu thereof, a 12-month coincident peak method for determining demand allocation (S. R., pp. 3-6). Applicant has objected to the staff recommendation.

As the Commission has observed on prior occasions, there are a number of valid allocation techniques available; but the choice in a given case must turn on which of the methods proposed most accurately recognizes power cost causation in light of the operating characteristics of the utility in question (*Ohio Power Company*, Case No. 75-161-EL-SLF [August 4, 1976]). It should be apparent that the two-peak method is only appropriate for those companies which exhibit a pronounced summer and winter peak. Although applicant may have fit this description

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

in the past, the test-year data, as the staff points out, shows a leveling of the monthly peaks (S.R., pp. 4-5, Tr. XX, p. 117). The lowest actual 1979 monthly peak (October) was 87 percent of the highest monthly peak (July) (S.R., pp. 4-5). In six other months, the peak was in excess of 95 percent of the annual peak (App. Ex. 6C). When the 1979 monthly peaks are plotted graphically, it is evident that the peaks have become hills and that the valleys have filled in (Tr. XX, p. 117). If the Commission limits its analysis to this data, it is clear that the staff's 12-month coincident peak method should be preferred. Indeed, this is the method applicant uses before the Federal Energy Regulatory Commission, although, in fairness, it should be noted that the FERC apparently now requires the use of the 12-month method (S.R., p. 5, Tr. XV, p. 13).

Applicant attempts to justify its continued use of the two-peak method by relying on estimates of the 1980 summer and winter peaks which, it contends, more accurately portray expected conditions. This novel approach is attended by several significant problems. First, from a conceptual standpoint, there should be some matching of the data sets involved in the determination of the allocation ratios and the property and expenses to which they are to be applied. After all, the purpose of the exercise is to assign existing plant based on existing demand, not to allocate future plant constructed to serve some future level of demand. However, quite apart from this theoretical consideration, is the question of the reliability of applicant's projections. The company attacks the staff method by claiming it does not adequately consider normal weather conditions (Tr. XX, pp. 113-115), an assumption automatically taken into account in applicant's forecast. No one disputes that temperature is a significant factor, but there are also other factors to be assessed such as the level of economic activity in the service territory, the

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

availability of the natural gas heating alternative, the impact of conservation efforts, the effect of rapidly increasing electric rates, and the track record of the company in predicting peak loads. On balance, the Commission does not believe that the test year data relied on by the staff is so unrepresentative as to yield an unreasonable result. Finally, we come to applicant's complaint that the staff method does not adequately consider daily operating characteristics because ten of the twelve monthly peaks were daytime peaks (App. Brief, pp. 27-28). Applicant attaches great significance to figures indicating that its daily load exceeds 90 percent of the daily peak for fifteen to nineteen hours on an average weekday basis (Tr. XV, p. 14). Because its projected winter peak is an evening peak, applicant contends that its method more properly weights the evening load's contribution to capacity requirements. This argument loses sight of the fact that both methods are peak responsibility methods and have nothing whatever to do with load duration. If applicant believes this diversity factor to be of such critical importance, the company should employ an allocation method specifically designed to recognize it rather than risk using a method which, in theory, could have resulted in the selection of two daytime peaks, thereby losing the evening load's contribution in its entirety. In fact, had applicant used calendar 1979 data, this would have been the case (App. Ex. 6C). The Commission does not believe that the staff method, which at least affords twelve measurements instead of only two, can be faulted on this score.

In light of the foregoing discussion, the Commission is of the opinion that the staff's 12-month method should be adopted for purposes of these proceedings. Although we do not view the fact that the FERC mandates the use of this method as being in any way controlling for the purposes at hand, there is a certain comfort in the sym-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

metry resulting from using the same allocation method in both jurisdictions; the sum of the parts cannot be greater than the whole. Further, the Commission finds applicant's proposed adjustment to reflect the anticipated reduction in contract demand associated nonjurisdictional service to the Cleveland Department of Public Utilities to be inconsistent with the matching concept referred to above. Although the Commission would agree that this change will have some impact on the nonjurisdictional load, we cannot conclude that this will be the only factor affecting the jurisdictional-nonjurisdictional load mix during the period these rates will be in effect. Moreover, this minor change in the contract demand does not automatically mean that the actual demand will track the reduction precisely. The evidence indicates that during the test year, when the Cleveland Department of Public Utilities contract called for 80 megawatts, monthly peaks actually ranged from 69.4 to 90.0 megawatts (Staff Ex. 2, pp. 6-7). The possible effect of this single change is not enough to convince the Commission to shelve the test-year concept. We, therefore, accept as reasonable the allocation ratios proposed by the staff.

**RATE BASE**

The applicant, the Commission staff, and Consumers' Counsel each offered testimony and submitted exhibits in support of their respective rate base proposals in these proceedings. The following table compares the company and staff estimates of the value of applicant's property used and useful in rendering the service affected by the application and the complaint and appeal as of the date certain of June 30, 1979. The adjustments to these proposals recommended by the various intervenors will be discussed on an item-by-item basis below.

## Opinion and Order, PUCO Case No. 79-537-EL-AIR

## Jurisdictional Rate Base

(000's Omitted)

	Applicant <sup>1</sup>	Staff <sup>2</sup>
Plant In Service .....	\$1,889,583	\$1,876,927
Depreciation Reserve .....	(464,602)	(466,049)
Net Plant In Service .....	\$1,424,981	\$1,410,878
CWIP .....	95,501	91,521
Working Capital .....	128,394	62,865
Deferred Taxes and Tax Credits .....	(25,087)	(79,215)
Jurisdictional Rate Base .....	<u>\$1,623,189</u>	<u>\$1,486,049</u>

<sup>1</sup>App. Rev. Sched. B-1<sup>2</sup>Staff Ex. 7, Appendix D, Rev. Sched. 7.1

The difference between the respective plant in service determinations of the applicant and the staff is, in part, attributable to the difference in the allocation methodologies employed. There are, however, additional reasons for the discrepancy in these figures which must be explored, as well as other related issues arising from intervenors' objections which must be considered.

**Land and Land Rights:**

As a part of its investigation in these proceedings, the Commission staff reviewed the company's land accounts in order to assure that the real property proposed for inclusion in rate base satisfied the statutory used and useful requirement. Similar staff analyses in prior cases involving this company have resulted in some transfers to future use or non-utility property accounts, and the staff inspection of additional parcels in connection with the cases now before us has again produced a recommendation that the rate base be adjusted (S.R., pp. 21-22). Specifically, the staff concluded that a deduction in the amount of \$368,938 was appropriate based on its finding that three ash disposal

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

sites associated with the East Lake plant were no longer used and useful and its opinion that the acreage at the Inland substation and Strongsville service center was in excess of that reasonably required for utility operations (S.R., p. 21; S.R., Sched. 8.2; Staff Ex. 2, pp. 8-11). Applicant objected to the deduction from rate base of the original cost dollars represented by these parcels and, through its witness Kemper, presented evidence in support of its position that the property in question was used and useful at date certain (App. Ex. 3A, pp. 4-7).

The staff excluded the Vine, Syracuse A, and Syracuse B ash disposal sites based on its conclusion that the capacity of these areas to receive fly ash had been exhausted. Applicant points out that one of the sites can still accommodate fly ash and is also being used to store cinders which are eventually sold to municipalities (App. Ex. 3A, p. 4). The Commission agrees that the value of this parcel, \$25,499, must be restored to rate base. The Commission does not agree, however, that the other two ash disposal sites constitute used and useful property as contemplated by the statute. Applicant acknowledges that these two parcels are filled to capacity, but argues that they are still satisfying one of their original purposes, holding fly ash. Further, the company claims that the sites have little resale value and, because land is not depreciable property, there is no way that any cost recovery or return can be realized unless the parcels are included in rate base. There is no merit in either of these arguments. Property can only be considered used and useful if it is utilized in providing service. The record is clear that the two parcels in question can no longer receive fly ash; thus, they do not meet this requirement. Moreover, the fact that the parcels may have limited resale value is totally irrelevant. Once the property has been found not to be used and useful, it goes without saying that ratepayers cannot be required to contribute toward a return on it. The Commission, therefore, accepts

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

the staff's rate base adjustment for these two ash disposal sites.

The staff's proposed deductions for excess land at the Inland substation and the Strongsville service center present much closer questions (Staff Ex. 2, pp. 10-11). The Commission has previously recognized that there are a number of factors which must be considered in evaluating adjustments involving the elimination of minor portions of land parcels on the theory that the total acreage at a site is above that reasonably required to support a given installation (*Ohio Edison Company*, Case No. 78-1567-EL-AIR, *et al.* [January 30, 1980]). Obvious practical constraints exist upon obtaining precisely the acreage necessary for a particular operation, and there is a possibility that severance damages would actually produce a net detriment to the ratepayer if a somewhat smaller parcel had, in fact, been acquired. Although the site maps introduced by the applicant might appear to suggest the need for this type of analysis in this case (App. Ex. 3A, pp. 28-29), the Commission finds the critical evidence in this area to be the admissions of applicant's own witness with respect to the company's specified plans for the future use of much of the area excluded by the staff at these two locations (App. Ex. 3A, pp. 5-6). Given this state of the record, we conclude that the dollar associated with these areas should properly be assigned to Account 105 (Land Held for Future Use) until such time as the planned construction is accomplished. Applicant's objection to the staff adjustments should be overruled.

**Beaver Valley Common Facilities:**

In arriving at its recommended rate base for purposes of these proceedings, the Commission staff excluded from plant in service the amount of \$8,894,241 which represents applicant's share of the common facilities at the Beaver Valley nuclear generating plant (S.R., p. 22; S.R.,

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Sched. 8.1). Because applicant's ownership interest in Beaver Valley is limited to Unit No. 2, a unit still under construction, the staff concluded that it would be improper to consider the company's share of the common facilities, although completed in connection with the first Beaver Valley unit, as used and useful property until such time as Unit No. 2 is placed in service. Applicant objects to the staff's treatment.

The Commission has had occasion to consider this precise question in a number of its recent decisions, including that issued in this company's last rate case (*Cleveland Electric Illuminating Company*, Case No. 78-677-EL-AIR [May 2, 1979]; *Ohio Edison Company*, Case No. 77-1249-EL-AIR [November 17, 1978]; *Toledo Edison Company*, Case No. 79-143-EL-AIR [February 29, 1980]). We have repeatedly held the staff adjustment to be proper, and nothing presented in this record would persuade us to alter that view (App. Ex. 4, pp. 43-44). Although the Commission recognizes that FERC accounting principles require that common facilities be classified as plant in service at the time the first unit is placed in service, this does not change the fact that the common facilities in question do not satisfy the statutory criteria for rate base eligibility (Section 4905.15(A)(1) Revised Code). *Cleveland Electric Illuminating Company* does not own Beaver Valley Unit No. 1. Although applicant's customers may, from time to time, receive power from the first Beaver Valley unit by virtue of certain CAPCO transactions, this does not render the portion of the common facilities assignable to Unit No. 2 used and useful property for ratemaking purposes. This objection is again overruled.

Applicant contends that if the common facilities are to be eliminated from rate base, consistency requires that the Commission direct the company to reclassify this property as plant held for future use, to cease accruing depreciation, and to resume the accumulation of AFUDC until

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

such time as Unit No. 2 is transferred to plant in service (App. Ex. 4A, p. 49). The staff has also recommended a reclassification of the property (S.R., p. 22). In the *Toledo Edison* case, *supra*, the Commission agreed that the principles underlying the exclusion of the common facilities from rate base dictate that the property be reclassified for Ohio regulatory purposes and directed that depreciation accruals be stopped. The Commission did not reach the question of the resumption of AFUDC in the context of that decision, but believes that such a measure would be inconsistent with the classification of the property as plant held for future use. The Commission, therefore, orders applicant to reclassify the Beaver Valley common facilities and to cease accruing depreciation. Applicant's proposal to resume AFUDC must be rejected.

**Davis-Besse Nuclear Plant:**

Through their filed objections, intervenors City of Cleveland and Senior Citizens *et al.*, contend that applicant's share of the Davis-Besse nuclear plant, a generating facility co-owned by Cleveland Electric Illuminating Company and Toledo Edison Company, should be excluded from the rate base on the theory that the plant is not "used and useful" within the meaning of that term as employed in Section 4909.15(A)(1) Revised Code. The Commission is on familiar ground in considering these objections as the City of Cleveland advanced similar arguments in the company's last rate proceeding (*Cleveland Electric Illuminating Company*, Case No. 78-677-EL-AIR [May 2, 1979]). The Commission's finding in that case that Davis-Besse was properly includable in rate base has just been affirmed by the Supreme Court (*City of Cleveland v. Public Utilities Commission*, S.Ct. Case No. 79-1158 [July 9, 1980], 63 Ohio St. 2d [1980]). Although a considerable portion of the record now before us is devoted

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

to this question, when the law and the evidence are sifted out from the rhetoric and the statements of counsel, the Commission once again comes to the same inescapable conclusion. Davis-Besse must and should be included in the rate base. This is a most difficult issue to address, not because it presents a close question, but because much of intervenors' attack is so illogical as to defy analysis (See, Tr. XXIII, pp. 73-81).

Rather than begin with counsel for the City of Cleveland's repeated charge that Davis-Besse is a "white elephant" that is unsafe and unreliable (City of Cleveland Brief, p. 4), it may prove more fruitful to begin with an unimpassioned look at the facts. No one, including company witnesses who were examined on the subject, disputes the fact that the unit's 1979 performance was extremely disappointing (Tr. VIII, p. 67). The plant actually produced only some 59 percent of its budgeted generation during the test year (Senior Citizens Ex. 1). It exhibited a unit capacity factor in 1979 of only 39.4 percent (City of Cleveland Ex. 2L). Davis-Besse was forced off line 15 times during the test period, although in five of those instances the duration of the outage was less than one day (City of Cleveland Ex. 8). The principal reason for the unit's poor annual availability factor was the 103-day shutdown mandated by the Nuclear Regulatory Commission in the wake of the Three Mile Island incident (City of Cleveland Ex. 8). In terms of production expense, Davis-Besse is by far the cheapest source of energy available to the company (City of Cleveland Ex. 4). Despite the three month outage referred to above and another extended outage in December of 1979, the unit contributed over 1.6 billion Kwh to applicant's system generation during the test year, roughly 10 percent of the company's total production (City of Cleveland Ex. 4). Where, in these facts, is there support for the proposition that Davis-Besse is not used and useful?

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Senior Citizens, *et al.*, suggests that if the plant cannot be excluded from rate base in its entirety, then, at minimum, the Commission should eliminate a portion of its value based on a calculation comparing its actual performance to its expected performance. The contention that utility property may be considered partially used and useful for rate base purposes is akin to the suggestion that someone can be partially pregnant. There is a well-established regulatory technique for dealing with the situation in which a generating unit exhibits an unusually high forced outage rate during the test year. The proper response is not the exclusion of all or part of the plant from rate base, but rather a normalizing adjustment to test period operations which excludes the costs associated with the outages in the calculation of future rates. This is precisely what the applicant and the staff have proposed in this case (App. Ex. 1, Sched. 3.12; S.R., p. 12). The approval of such an adjustment for ratemaking purposes places the ratepayers in exactly the same position with respect to future rates as if the plant had operated at anticipated levels.

At this point, intervenors' arguments became more difficult to comprehend. The Commission assumes they understand that operations have been normalized, so they must be suggesting that even if the plant performed as expected, it should still be excluded from rate base. Intervenors assert that the plant is unsafe and suffers from significant design and construction defects. The Commission is, of course, concerned about the risks associated with nuclear generation in general, and Davis-Besse in particular; but this is an area where the federal government has clearly pre-empted state regulatory authority. *Northern States Power Co. v. Minnesota*, 447 F.2d 1143 (8th Cir., 1971), *aff'd*, 405 U.S. 1035 (1972). *See also*, *Stebbins v. Public Utilities Commission*, S.Ct. Case No. 79-1622 (June 25, 1980), 62 Ohio St. 2d(1980). Moreover, nothing in this record indicates that the plant is unsafe.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

What the evidence does show is that in each instance where a problem forced the unit off line, the problem was identified, reported, and remedied to the satisfaction of the Nuclear Regulatory Commission, the agency that does have authority in this area. It is true that the NRC has ordered a number of modifications, and that some of these have been quite costly (Tr. XXIII, p. 130); but it must be remembered that the plant has been subject to NRC scrutiny since the time it was on the drawing board and that it was and is licensed to operate.

Subsequent to the Commission order in the company's last case, the Supreme Court of Ohio issued its decision in *Consumers' Counsel v. Public Utilities Commission*, 58 Ohio St.2d 449 (1979). This case represented an appeal of a Toledo Edison rate order (*Toledo Edison Company*, Case No. 76-1176-EL-AIR [June 9, 1979]) wherein the Commission had determined that the Davis-Besse plant should be considered used and useful and, therefore, includable in rate base despite the fact that it had not been assigned commercial operating status before the date certain. The Commission based this conclusion on the fact that the unit had been synchronized with the system and was producing electricity, albeit through test generation, prior to date certain. The Court reversed, finding as follows:

"It would be inequitable to prematurely shift the risk of plant failure from the utility's investors to the ratepayers by the inclusion in the rate base of highly complex and innovative technology which has not been proven to be reasonably free from significant design or construction defects. The initial risk of failure is appropriately borne by the investors, who have undertaken the project and who will ultimately profit from its success. It is only proper that their venture be found operational before they commence to recoup their capital outlays from the consumers." *Consumers' Counsel*, *supra*, pp. 456-457.

Intervenors, consistent with their assertion that the plant is unsafe, place great emphasis upon this language

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

as support for the proposition that Davis-Besse should not be included in the rate base in this case. However, the fact pattern presented to the Court in *Consumers' Counsel, supra*, was quite different than that with which the Commission is confronted in the instant proceedings. In that case, although there was test generation, the unit was not producing net energy for the consumer before the date certain. Here, the plant in question has been operational since 1977; the date certain was June 30, 1979. It has produced vast quantities of energy during that period of time. This is not a date certain timing problem of the type addressed by the Court. Further, if the Commission were to deny the company a return on Davis-Besse, consistency would require that test-period operations be adjusted to reflect an assumption that the plant was not available. We doubt that consumers would appreciate the impact of such a measure.

The City of Cleveland accuses the Commission of failing to recognize that applicant's share of Davis-Besse ended up costing about four times more than the company originally expected (Tr. VIII, p. 74) and that if these costs, plus the costs still being incurred to meet changing NRC requirements, are taken into account in computing costs per Kwh, Davis-Besse is no bargain. Intervenor goes so far as to assert that "the capital costs associated with Davis-Besse are the primary cause of the CEI financial problems" (City of Cleveland Brief, p. 4). Assuming for the sake of argument that this statement is correct, how would the exclusion of the plant from rate base do anything but exacerbate these problems? The fact is that the capital costs associated with the construction of all types of capacity have skyrocketed (Tr. VIII, p. 61). Although the problem is more acute with respect to nuclear plants due to ever-tightening licensing requirements, the hope was and is that the output from Davis-Besse over its life will cost substantially less than any alternative construction the

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

company could have undertaken in the same time frame (Tr. VIII, p. 69). The relevant point is that the investment in the plant has been made, the plant is providing service, and the suppliers of the required capital are entitled to a return on their investment.

There are other inconsistencies in intervenors' arguments that should not go unnoticed. The City of Cleveland complains that it costs the ratepayers approximately \$800,000 per week for each week the plant does not operate (City of Cleveland Brief, p. 3). Which way does this cut? We would have thought that this testifies to the benefit of having Davis-Besse on the system. Then, there is the suggestion by Senior Citizens, *et al.*, that the uncertainties associated with Davis-Besse increase risk, thereby driving up investors' return requirements (Senior Citizens Brief, p. 21). We would merely inquire as to what impact on the company's cost of capital intervenor would anticipate were the Commission to disallow any return on the tremendous investment in this plant as it would have us do. Finally, we come to the theory that if the Commission includes Davis-Besse in rate base, the company will have no incentive to seek legal redress for any losses occasioned by the alleged defects in the design or construction of the unit or by the alleged negligence of Toledo Edison personnel in managing its operation. Senior Citizens', *et al.*, even suggests that if the Commission recognizes Davis-Besse for ratemaking purposes, such a step would afford a defense in any legal action that applicant might maintain. These arguments are totally without merit. In the first place, they assume that the company has some actionable claim arising out of the unit's admittedly poor performance. It would certainly be improper for the Commission to engage in speculation in this area, and even more improper to base a rate case deduction on the innuendo of intervenors' attorneys. Detailed contracts and agreements govern applicant's relationship with those firms that constructed and operate Davis-Besse.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Intervenors should examine their provisions before spreading these assertions on the record. The Commission cannot deny applicant a return on this plant at this point in time with the instruction that it go sue someone or other in hopes that it will recover something from them in the future. If it should eventuate that applicant does obtain some recovery through litigation, whether involving Davis-Besse or any other aspect of its operation, under circumstances where customers are entitled to share in the benefits the Commission will see to it that they are properly credited (*Ohio Power Company*, Case No. 77-380-EL-FAC (February 7, 1979); *Ohio Power Company*, Case No. 78-676-EL-AIR [April 16, 1979]). There is simply no basis in law or fact for excluding all or part of the net original cost of Davis-Besse from the rate base determined for purposes of these proceedings.

**Excess Capacity:**

The Commission staff, as a part of its investigation in these proceedings, examined applicant's generating capacity to determine whether capacity exists which exceeds that reasonably required to meet the company's net peak demand and afford a reasonable reserve margin. As a result of this review, the staff concluded that applicant's production system was not excessive (S.R., pp. 22-23; Tr. XXI, pp. 114-120). Intervenors City of Cleveland and Senior Citizens, *et al.*, object to the staff's finding, contending that the staff analysis was inadequate and that the company does have excess capacity. Claiming, without a shred of evidence as to why the figure should be accepted, that a 20 percent reserve margin is appropriate, intervenors propose a rate base deduction, never quantified, to exclude capacity in excess of this amount on the theory that such property is not used and useful. The short answer here would be to simply point out that there is nothing in this record, save for intervenors' bare assertions, that would

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

support these objections. However, the Commission will once again set out the considerations which must be taken into account in dealing with this question.

This so-called "excess capacity" issue has been before the Commission time and time again in recent years in cases involving almost all major electric companies subject to our jurisdiction, including this applicant. (See *e.g.*, *Dayton Power and Light Company*, Case No. 76-823-EL-AIR [July 22, 1977]; *Monongahela Power Company*, Case No. 76-824-EL-AIR [September 7, 1977]; *Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979]; and *Cleveland Electric Illuminating Company*, Case No. 78-677-EL-AIR [May 2, 1979]). One fact that has clearly emerged from these cases, as it has from the record in the instant proceedings, is that it is most inappropriate to measure the reasonableness of existing capacity levels by a simple comparison to some assumed ideal reserve margin (Tr. VIII, pp. 106-109; Tr. XXI, pp. 116-117). Reserve requirements are company-specific, and what is reasonable for one electric utility may not be reasonable for another depending on factors such as unit sizes and generation mix. Next, assuming appropriate reserve criteria can be established, it must be recognized that in light of the extensive lead times involved in the construction of generating facilities and the variety of factors which can influence load growth, it is obviously unrealistic to assume that any utility would have the forecasting capability which would allow it to add capacity in the precise increments required to maintain the theoretically appropriate margin. This problem is intensified by the large size of the units being added today. Thus, the relevant inquiry is not whether the reserve at any point in time matches some optimum margin, but whether, given all those factors which can influence construction and load growth, the company can be fairly said to have acted imprudently in its capacity planning. As we will discuss in more detail *infra*, there has been no showing that this has been the case with respect to this applicant.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Finally, there is the conceptual problem which attends a capacity adjustment based on the theory that a portion of a company's production capacity is not used and useful. All applicant's generating stations, although they may have been downrated or off line from time to time, were in service meeting customer demand pursuant to principles of economic dispatch during the test period. Thus, each unit, standing alone, clearly would meet the used and useful requirement. A percentage adjustment to system capacity ignores the reality that such capacity is comprised of individual units which represent actual substantial dollar investments committed to assure that adequate service can be maintained. As the Commission stated in the *Columbus and Southern* decision cited above:

"Hindsight is always perfect, and before the Commission will consider denying a return on property actually used in providing service something more need be shown than that the company's foresight was not."

Intervenors' objections are, hereby, overruled.

**Depreciation Reserve:**

Section 4909.05(H) Revised Code requires that the Commission determine the proper and adequate reserve for depreciation to be deducted from the original cost of applicant's used and useful property. The staff, in the course of its investigation, tested applicant's booked reserve against a theoretical reserve study based on date certain balances and found excellent correlation, indicating that the booked reserve might properly be relied on for ratemaking purposes (S.R., pp. 23-24). The staff did take exception, however, to a retroactive adjustment to the reserve performed by applicant in order to reflect the change to the units-of-production method of depreciation for the nuclear plant accounts as authorized by this Com-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

mission in *Determination of Depreciation Charges*, Case No. 77-1369-EL-UNC (December 12, 1979). The Commission considered this same question in its order in *Toledo Edison Company*, Case No. 79-143-EL-AIR (February 29, 1980), finding such an adjustment to be appropriate. The staff revised its recommendation at hearing to conform to that decision and this step, together with a correction to reflect normalized generation for Davis-Besse, essentially removes the matter from controversy (Staff Ex. 2, pp. 11-12). The remaining differences between the applicant and staff reserve recommendations are tied to their respective positions on certain other rate base, allocation, and normalization issues. As those questions have been resolved in favor of the staff, the Commission adopts the staff's proposed jurisdictional depreciation reserve of \$466,049,256 as the proper deduction from plant in service for purposes of these proceedings (Staff Ex. 3, Rev. Sched. 9). Deducting this amount from the original cost of includable property results in a finding of jurisdictional net plant in service of \$1,410,903,292.

**Construction Work In Progress:**

Section 4909.15(A)(1) Revised Code provides that the Commission, in its discretion, may include in its rate base determination a reasonable allowance for construction work in progress. The statute limits eligibility for the allowance to projects which are 75 percent complete, and there is a further prohibition against authorization of such an allowance to the extent it would exceed 20 percent of the total valuation not including this item (Section 4909.15 (E) Revised Code). For purposes of these proceedings, applicant originally requested an allowance for construction work in progress of \$99,263,076, which reflected the jurisdictional date certain costs associated with some 171 job orders considered by the company to represent qualifying projects (App. Ex. 1, Sched. B-4). The requested

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

allowance was subsequently reduced to \$95,501,269 in light of applicant's acceptance of a staff adjustment which reclassified 48 of the job orders based on a finding that the construction in question was complete and the property in service at date certain (App. Ex. 3A, p. 28; App. Rev. Sched. B-1). The staff recommends a jurisdictional allowance of \$91,521,464 (S.R., pp. 24-25; S.R., Sched. 10). Consumers' Counsel, although opposed in principle to an allowance for construction work in progress, has accepted the staff's recommendation as reasonable (O.C.C. Ex. 1, pp. 7-8); but the City of Cleveland and Senior Citizens, *et al.*, contend that there should be no construction work in progress allowance authorized in these cases.

The claims of the intervenors opposing any allowance for construction work in progress require no more than a cursory discussion, as much of what has been argued here has been heard and rejected many times in the past (See *Ohio Edison Company*, Case No. 78-1567-EL-AIR [January 30, 1980] and cases summarized therein). Senior Citizens' contention that the statute creating the allowance is unconstitutional has been definitively laid to rest (*Consumers' Counsel v. Public Utilities Commission*, 58 Ohio St. 2d 108 [1979]), and its charge that the Commission is "stumbling along" trying to define some standards for the exercise of the discretion conferred by Section 4909.15(A)(1) Revised Code is unfounded (*Ohio Edison Company*, *supra*). Intervenors' specific objection to the inclusion of Project No. 1974 IBM, applicant's share of Unit No. 3 at the Bruce Mansfield generating station, does warrant some comment. This item constitutes some \$90 million of the total allowance requested and there is no dispute that the project meets all the statutory eligibility criteria (App. Ex. 1, Sched. B-4). However, in keeping with their assertion that the company already has excess generating capacity and their opinion that applicant has demonstrated no compelling financial need, the City of Cleveland and Senior Citizens, *et al.*, urge the Commission

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

to ignore this substantial capital investment in establishing rates in this case. Given our perception of the purpose of the statutory provision allowing consideration of construction work in progress as explained in *Columbus and Southern Ohio Electric Company*, Case No. 77-545-EL-AIR (March 31, 1979), and recently reiterated in *Ohio Edison*, *supra*, we would think that there would be less room for argument concerning the propriety of including Mansfield Unit No. 3 than any other of the items for which applicant has requested recognition. In light of the Commission's rejection of intervenors' excess capacity theory and consistent with our prior holdings with respect to proposed "overwhelming need" standards, the Commission overrules these objections (*Dayton Power and Light Company*, Case No. 76-823-EL-AIR [July 22, 1977]; *Cleveland Electric Illuminating Company*, Case No. 78-677-EL-AIR [May 2, 1979]).

As indicated above, the difference in the applicant and staff construction work in progress recommendations is relatively minor, and part of the remaining disparity is attributable to the difference in the allocation methods employed. Yet despite the comparatively small total dollar difference between the respective proposals, there are some 76 individual job orders still in dispute (S.R., p. 25). The basis for applicant's objection to the staff exclusion for each of these items is set out in the testimony of applicant's witness Kemper (App. Ex. 3A, pp. 10-28). Given the obvious constraints which preclude the Commission from proceeding with an individual analysis of each one of these job orders within the confines of this written opinion, we believe it reasonable to resolve the matter through a more general discussion. In light of the fact that the Commission has previously indicated that it believes the purpose of the allowance to be to recognize the existence of major new construction projects, it is tempting to simply eliminate a number of these items as not constituting the type of evidence contemplated by the

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

statute. However, the staff has inspected each of these items and has offered additional reasons why they should not be considered (Staff Ex. 1, pp. 3-18). Nothing in this record would persuade us that the allowance recommended by the staff is unreasonable.

Applicant begins its criticism of the staff's findings by suggesting that the Commission should, as a matter of policy, recognize in the allowance any expenditures relating to efforts to improve power plant productivity or required by various governmental agencies for environmental or safety reasons (App. Ex. 3A, p. 9). The unfortunate negative implication of this recommendation is that if the Commission fails to adopt these criteria it is unconcerned about applicant's productivity, the environment, or the public safety. We trust that all concerned will recognize this smoke screen for what it is and will realize that the real issue here is whether or not the expenditures represent qualifying construction projects under the statute and our past decisions.

Review of the testimony of staff witness Weiss indicates that the reasons underlying the staff's exclusion of the projects now in issue fall in four basic categories (Staff Ex. 1, pp. 3-18). Some were excluded because the staff found them to be less than 75 percent complete. Several were eliminated upon a finding that they represented a purchase rather than a construction project. Others were excluded because they were of a replacement nature. Finally, there were exclusions based on the conclusion that the expenditures involved were more properly associated with maintenance rather than construction. In several instances, the exclusion was tied to more than one of these reasons. Each one of the identified criteria has been recognized by the Commission in past cases as representing an appropriate standard by which to test the eligibility of specific expenditures for inclusion in the construction work in progress allowance (S.R., p. 25). Moreover, the Commission has also pointed out that there is

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

judgment involved in applying every one of these tests. Despite the complaints from those who would have the Commission establish rigid rules to be strictly applied in every case, we continue to believe that judgment must play an important role in determining what evidence is properly considered in authorizing an allowance for construction work in progress in a given case.

For purposes of illustration, consider the Commission's determination that items which constitute purchases are not construction projects within the meaning of the statute. The logical foundation of this standard is so clear that an explanation is almost superfluous. An item acquired by a utility through a single-payment transaction is either in service at date certain and, therefore, in rate base, or it is not, and no return may be earned on it. A purchase is not construction, nor is it a project. Applicant's job order no. 50030, a caterpillar tractor-scraper acquired for use at one of the company's power plants, is a clear-cut example of a purchase (App. Ex. 3A, p. 23). It was properly excluded by the staff (Staff Ex. 1, p. 14). But compare this situation to job order no. 50228, a crawler tractor purchased and delivered prior to date certain but which required additional company labor before it was ready for use (App. Ex. 3A, p. 22; App. Ex. 3B). Does this change its essential nature from a purchase to a construction project? The Commission would agree with the staff conclusion that it clearly did not (Staff Ex. 1, p. 13), but there is now an element of judgment involved.

This same element of judgment is also present to some degree in each of the other tests the staff employed. The staff's finding that several of the job orders proposed for inclusion by applicant were not 75 percent complete followed from the staff's opinion that these items, because of their scope and purpose, should be examined individually and not considered as a part of a larger project as the company had suggested (Staff Ex. 1, p. 7). The exclusion

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

of items on the ground that they represent replacement projects or maintenance work also requires that a view be taken as to the basic characteristic of the expenditure (See *Toledo Edison Company*, Case No. 79-143-EL-AIR [February 29, 1980]). In each instance, the Commission believes the treatment recommended by the staff to be consistent with the intent of the statute and, therefore, finds that the construction work in progress allowance proposed by the staff should be adopted for purposes of these proceedings. Those items excluded are not properly defined as major new construction when the amount of the obligated capital involved is considered in connection with time period for which it has been committed and the purpose to which it has been put. Applicant's objection is overruled.

**Working Capital:**

The applicant, the staff, and Consumers' Counsel each proposed an allowance for working capital to be included in the rate base valuation in accordance with the provisions of Section 4909.15(A)(1) Revised Code. All three estimates were derived through the use of the formula approach, but there are significant differences between the results of the respective calculations. Applicant requests an allowance of \$128,393,775 (App. Rev. Sched. B-1), while the staff's recommended allowance is \$62,865,000 (Staff Ex. 7, Rev. Sched. 7). Consumers' Counsel's calculation resulted in a proposed allowance of \$56,935,000 (O.C.C. Ex. 1, Rev. Sched. JTC-2). Issues exist with respect to each element of the formula which we will address, in turn, below.

The difference in the cash component of the formula as presented by the parties is, in part, the product of the sponsors' respective positions on various expense issues and, in some measure, created by the difference in allocation methods. The most significant difference, however,

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

arises from the fact that the applicant failed to exclude fuel expense from operation and maintenance expenses in computing its proposed cash allowance. Staff witness Hanna and Consumers' Counsel witness Chapski both believe this deduction to be appropriate (Staff Ex. 7, p. 12; O.C.C. Ex. 1, pp. 12-13). Much of the debate on this point has centered on applicant's complaint that fuel expense was not deducted under the original formula as propounded by the FPC (now FERC) (App. Brief, p. 12). Be that as it may, it is clear that this Commission has consistently excluded fuel expense under its version of the formula for some years, and, in most instances, without objection from the utility involved (See, e.g., *Ohio Edison Company*, Case No. 78-1567-EL-AIR [January 30, 1980]). The Commission has cited as one of the virtues of the formula method for determining a working capital allowance that it assures evenhanded treatment among rate applicants (*United Telephone Company of Ohio*, Case No. 72-995-Y [September 9, 1974]). It has never suggested that the formula does more than approximate the result of a full-blown lead-lag study. If applicant wishes to depart from this formula on the grounds that it does not properly recognize one item or another, we suggest that it support this claim with a properly conceived lead-lag study which examines all the timing differences involved between when expenses are incurred and payments are received. Applicant's objection is overruled.

The applicant and the staff utilized the date certain balance for purposes of determining the materials and supplies component of the working capital formula. Consumers' Counsel witness Chapski used the average of thirteen monthly balances in arriving at his recommendation with respect to this component, a technique approved by the Commission on numerous past occasions, including this company's last rate case, on the grounds that it may

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

produce a more representative allowance. The staff has indicated that one of the reasons it utilized the date certain balance in this case was that actual test-year data was not available at the time of its audit (Tr. XXI, pp. 174-175). This data is now available to the Commission through Senior Citizen's Ex. 10, and the Commission concludes that the thirteen monthly balance method may properly be adopted utilizing the information contained therein. Jurisdictional materials and supplies calculated on this basis total \$19,034,217. This amount must then be adjusted to eliminate those materials and supplies held for new construction, extensions and additions in accordance with the decision of the Supreme Court in *City of Cincinnati v. Public Utilities Commission*, 160 Ohio St. 2d 395 (1954), and the consistent practice of the Commission in implementing that decision. Applicant objects to this adjustment, claiming that the materials and supplies inventory is not maintained with a view as to the ultimate purpose to which individual items may be put (Tr. II, p. 83). This may well be true, but it certainly does not preclude an after-the-fact analysis of the use to which the items are actually put (S.R., Sched. 11A). The Commission finds the staff adjustment to account for this consideration to be reasonable and proper in all respects. Application of this adjustment factor to the inventory as determined above produces an allowance for materials and supplies of \$16,491,246 which we deem reasonable for purposes of determining the working capital allowance to be authorized in these proceedings.

The fuel inventory allowance is composed of three separate items: oil, coal, and deferred nuclear fuel. Differences exist in each of these areas. Applicant based its proposed allowance for oil on a targeted capacity supply level of 90 percent (App. Ex. 5A, p. 13). The staff and Consumers' Counsel are in general agreement that 78 percent of capacity represents a more reasonable inventory

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

level in light of the company's actual experience (S.R., p. 25; Staff Ex. 6, p. 7; O.C.C. Ex. 1, p. 11). Applicant's witness Chopp was unable to explain the derivation of the the 90 percent target, nor was he aware if 90 percent of tank capacity had ever actually been achieved (Tr. II, pp. 98-100). It was certainly not achieved in the test year. Under these circumstances, the Commission believes the staff's proposed allowance for the oil inventory is on much firmer footing, and we will accept the staff's recommendation with respect to this component of the fuel inventory allowance.

The determination of the proper allowance for the coal inventory has been a subject attended by considerable debate in these proceedings. Applicant originally based its proposed allowance on the assumption that a 63.33-day supply represented a reasonable inventory balance (App. Ex. 5, pp. 16-17). This number was derived through what can only be described as a rather primitive analysis based on the assumptions that the company maintains a 50-day supply in a normal year and a 90-day supply during a year in which a UMW contract is up for renewal. As the miner's contract runs for a three-year period, the calculation assumed two years at the 50-day level and one year at the 90-day level producing a weighted average of 63.33 days. Cross-examination by counsel for Senior Citizens, *et al.*, quickly pointed up the flaw in this logic, as it is apparent that even if one accepts the validity of the general approach, a 90-day supply would not be maintained throughout the third year, but would gradually be built up in anticipation of a possible strike and would dissipate as the threat of the strike passed or as the reserves were called on in the event a work stoppage actually occurred. Mr. Chopp conceded the point (Tr. III, pp. 55-57). This prompted applicant to revise its calculation, this time assuming a 50-day supply in the first two years and a gradual build up and decline in the third year. The resulting weighted average became 55.3 days (App. Ex. 5G), and, based on this

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

calculation, the company now claims a 55-day coal inventory to be a reasonable basis for establishing the coal allowance. Rather than engage in this speculation, both staff witness Hefner and Consumers' Counsel witness Chapski pegged their recommended allowances to the actual experience of the company. Mr. Hefner, based on date certain data, a review of the monthly balances, and consideration of applicant's budget as it related to coal procurement concluded that a 45-day supply was reasonable (S.R., p. 25; Staff Ex. 6, pp. 6-7; Tr. XXI, pp. 48-49). Mr. Chapski simply relied on the average of the thirteen monthly balances, December, 1978, through December, 1979, in arriving at his recommended allowance which is slightly below that proposed by the staff in terms of actual dollars (O.C.C. Ex. 1, p. 11).

Applicant challenges the conclusions of these witnesses on several counts. The company argues that the use of test-year data is inappropriate, asserting that coal inventory levels in 1979 were lower than normal due to uncertainties arising from questions as to what low sulphur-high sulphur coal mix would be permitted (App. Ex. 5A, p. 14) and due to the fact that the current UMW contract was only in its second year. Applicant presented an exhibit showing that the monthly balances from the three-year period 1976 through 1978 averaged 55 days (App. Ex. 5B). However, when the 1979 data is added to this table a somewhat different picture emerges (Tr. VI, pp. 69-70). Although applicant claims that test-year inventory levels were lower than normal, the 1979 average of the monthly balances, 37.4 days, is actually higher than the 1978 average of 36.5 days (App. Ex. 5B). These numbers are both quite different from the 50-day supply applicant contends should be associated with the years where no strike is imminent. Certainly a plausible interpretation of this data is that the company considered the inventory remaining at the conclusion of the strike in March of 1978 to be reasonably adequate under the circumstances. If one employs appli-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

cant's three-year weighted average approach using actual data rather than the assumed inventory levels utilized by the company, the results confirm the reasonableness of the staff's recommended allowance. The average monthly balance for 1977, the year of the strike, constituted a 66.3-day supply. Adding this to twice the 1978 average of 36.5 days and dividing by three yields a 46.4 day supply, a far better match with the staff's 45-day supply than with the company's 55-day recommendation.

Applicant's witness Chopp described the 45-day supply recommended by the staff as being "dangerously close" to the 40-day level specified by the Commission in Case No. 77-1139-EL-COI as the point at which the Company is permitted to abandon economic dispatch (App. Ex. 5A, p. 14). Taken at face value, this might be cause for concern; but the fact is that the company never had a 40-day monthly balance from March of 1978 through July of 1979 (App. Ex. 5B). As the staff points out on brief, the 40-day trigger becomes important only during the period of a strike where all utilities face the threat of service interruption (Staff Brief, p. 6). The Commission concedes that the 45-day supply recommended by the staff appears conservative in light of our findings in other recent electric cases, but we believe the staff recommendation to be the best supported on this record and will adopt the staff's proposed allowance for the coal inventory.

The remaining fuel-related issue to be considered is the appropriate allowance for deferred nuclear fuel. There are two separate questions in this area which must be resolved. Under the leasing agreement between the owners of Davis-Besse and the lessor of the nuclear fuel for the plant, applicant was required to begin payments for nuclear fuel in November 1976, whether or not the plant was in operation (App. Ex. 5A, p. 11). This plant actually was not placed in service until almost a year later, and additional time elapsed before final approval from the Nuclear Regulatory Commission to operate it at full load

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

(App. Ex. 5A, p. 12). The jurisdictional value of the investment in the fuel core is, of course, properly included in the working capital allowance. This balance is subject to reduction as payments are made to the lessor. Proper accounting dictates, however, that the nuclear fuel be expensed at the time when the fuel is consumed, even though the lease payments are actually made monthly under the terms of the contract (App. Ex. 5, p. 10). Thus, those payments made prior to the commercial operation of the plant are being amortized over the actual fuel burn-up (App. Ex. 5, p. 15). Applicant charged AFUDC on the payments made during this period (App. Ex. 5A, p. 12). The staff recommends that this AFUDC component, \$228,835, be eliminated for purposes of determining the working capital allowance, contending that AFUDC was not properly chargeable on these payments as they do not represent construction costs of the type subject to AFUDC accumulation (Staff Ex. 7, p. 21; Staff Ex. 3, Rev. Sched. 11). The Commission agrees that this component should be eliminated. In so finding, we do not in any way suggest that applicant acted imprudently in entering into the leasing arrangement at the time it did, but we do not believe it consistent with the concept of a reasonable working capital allowance to charge ratepayers with these additional costs. Applicant's objection is overruled.

The applicant and the staff relied on the date certain balance for purposes of determining the allowance for deferred nuclear fuel (App. Ex. 1, Sched. B-5.1; Staff Ex. 3, Rev. Sched. 11). Consumers' Counsel used the average of thirteen monthly balances, which produced a somewhat lower figure (O.C.C. Ex. 1, p. 11). Senior Citizen's *et al.*, objects to these methods, arguing that they improperly charge ratepayers for increases in the balances caused by the extended outage of Davis-Besse in the late spring and early summer of last year (Senior Citizens Brief, pp. 9-10). As explained above, because nuclear fuel is expensed only when it is actually consumed, the balance will increase

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

under the operation of the lease in those periods when Davis-Besse is not on line. As intervenor correctly observes, the date certain balance is the second highest of the test-year monthly balances (App. Ex. 5E). As other aspects of test-year operations have been normalized so as to protect ratepayers from charges attributable to the unit's poor performance, we see no reason why the allowance for deferred nuclear fuel should not be accorded similar treatment. Applicant's witness Chopp agreed that there was no theoretical difference between such an adjustment and those made in other areas (Tr. VI, pp. 67-68). The evidence now before us will not permit the Commission to precisely calculate such an adjustment, but we believe a reasonable proxy for a normalizing adjustment of this type to be to establish the allowance for deferred nuclear fuel with reference to the average of the thirteen monthly balances adjusted so as to eliminate the three months of the TMI-related shut down (App. Ex. 5E). The results of this calculation produce a jurisdictional average of the ten remaining monthly balances of \$7,013,586. The Commission is of the opinion that this represents a reasonable allowance for deferred nuclear fuel.

The largest single cause of the disparity between the applicant's working capital recommendation and that proposed by the staff and Consumers' Counsel stems from the fact that applicant failed to include an offset to the working capital allowance to reflect the availability of accrued taxes as required by the decision of the Supreme Court in *Cleveland Electric Illuminating Company v. Public Utilities Commission*, 42 Ohio St. 2d 403 (1975). Applicant has presented nothing new in support of its objection to the offset; in fact, it has presented almost nothing at all. Consumers' Counsel's objection that the offset should include FICA taxes has also been disposed of by prior Commission decisions (See *Columbus and Southern Ohio Electric Company*, Case No. 77-545-EL-AIR [March 31, 1978]). The tax offset proposed by the staff is hereby approved.

# Opinion and Order, PUCO Case No. 79-537-EL-AIR

The final area of disagreement relates to the deduction for customer deposits required by the decision of the Supreme Court in *Consumers' Counsel v. Public Utilities Commission*, 58 Ohio St. 2d 108 (1979). Applicant, consistent with its apparent theory that precedent should be ignored if it works to the company's disadvantage, made no such deduction. The staff, in accordance with prior Commission decisions, treated the jurisdictional customer deposit balance as an offset to working capital, while *Consumers' Counsel* contends that it should be subtracted directly from rate base. As the Court indicated in the *Consumers' Counsel* decision, *supra*, the practical effect of either technique is the same. The Commission finds the deduction of \$833,000 proposed by the staff to be appropriate, and will express the deduction as a working capital offset for purposes of these proceedings.

The following schedule presents in summary form the Commission's determination of the allowance for working capital to be included in rate base for purposes of these proceedings. These figures take into account revisions necessary to reflect the disposition of those other issues which affect the allowance.

## Jurisdictional Working Capital Allowance (000's Omitted)

Cash Element	
(½ of Adjusted Operation and Maintenance Expense, excluding Fuel and Purchased Power) .....	\$ 20,335
Materials and Supplies .....	16,491
Fuel Inventory	
(Including Deferred Nuclear Fuel) .....	47,012
Tax Offset	
(¼ of Adjusted Taxes, excluding FICA and deferred FIT) .....	(20,480)
Customer Deposits .....	(833)
Jurisdictional Working Capital Allowance	<u>\$ 62,525</u>

**Opinion and Order, PUCO Case No. 79-537-EL-AIR****Accumulated Deferred Taxes and Tax Credits:**

In every rate order issued since interperiod tax allocation became permissible under Section 4909.15(A)(4) Revised Code, this Commission has reduced the rate base of normalizing utilities by an amount equal to the balance of accumulated deferred taxes and tax credits which may be deducted without loss of benefit under the applicable provisions of the Internal Revenue Code. Although this practice is consistent with the customary regulatory treatment of these items throughout the country (Tr. XI p. 3), the Commission continues to be subjected to theories advanced by applicant utilities as to why such an adjustment is improper or inappropriate. Mercifully, the barrage has slowed somewhat of late, and in this case applicant has primarily directed its objection to the amount of the deduction rather than to its propriety.\*

The staff proposes a reduction to rate base in an amount equal to the date certain balance of jurisdictional accumulated deferred income taxes associated with liberalized depreciation (Account 282) and accelerated amortization (Account 281), and the date certain accumulated deferred investment tax credits (Account 255, 3 and 4 percent components only). (S.R., p. 26). The total deduction is \$79,215,257 (S.R., Sched. 12). Applicant also reduced rate base to reflect these balances, but restricted its origi-

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\* Applicant did again raise the now familiar "Congressional intent" argument considered and rejected by the Commission in the company's last rate case (Case No. 78-677-EL-AIR [May 2, 1979]). The Commission has no quarrel with applicant's interpretation that the tax credits involved were authorized to provide an incentive for capital investment; but the rate base deduction is not inconsistent with that intent (Staff Ex. 7, pp. 27-28). Congress has specifically indicated those circumstances under which a rate base deduction is not permitted without loss of the benefit, and the Commission has made no adjustment in those instances (Section 46(f), Internal Revenue Code).

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

nal adjustment to some 44 percent of that proposed by the staff based on a purported identification of the risk-related portion of the deferred amounts (App. Ex. 1, Sched. B-8; App. Ex. 4, pp. 45-48). Through his supplemental testimony, applicant's witness Maugans now proposes an even more limited reduction based on the theory that only the deferred amounts actually recovered through rates may properly be deducted from rate base (App. Ex. 4A, Appendix 6; App. Ex. 4A, pp. 33-38). The Commission finds neither of these arguments persuasive.

Able cross-examination by staff counsel made short work of the novel concept that a risk differential exists with respect to a portion of the deferred balances and credits which dictates that they be included in rate base (Tr. XI, pp. 2-33). Mr. Maugans apparently concedes that the accumulated deferrals represent interest-free capital and, as such, may properly be deducted from rate base (Tr. XI, p. 20). However, the witness then draws a distinction between the terms "interest-free" and "risk-free" in arguing that a return should be allowed on a portion of the balances (Tr. XI, p. 20). The risk to which Mr. Maugans makes reference in the risk that the ultimate tax liability associated with the deferrals will not be paid. This risk is so obviously a risk to the federal government as opposed to one borne by the investors that this matter merits no further discussion. Indeed, applicant has abandoned the argument on brief.

The alternative deduction presented through Mr. Maugan's supplemental testimony is based in language appearing in the Commission's decision in *Ohio Power Company*, Case No. 78-676-EL-AIR (April 16, 1979) to the effect that a determination must be made as to whether existing rates reflect normalization before a rate base reduction for deferred taxes can properly be made (App. Ex. 4A, p. 35). In light of this statement, Mr. Maugans attempted to calculate the portion of the deferred balances

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

which had actually been recovered through past rates and concluded that a rate base deduction of no more than \$25,687,045 was appropriate (App. Ex. 4A, p. 37). Although there are very real problems presented by the assumption that the amount of the recovery through past rates can actually be identified, the Commission need not consider this point in view of our conclusion that applicant's reliance on the language cited is misplaced. First, the Commission would point out that the discussion in *Ohio Power, supra*, related solely to the question of the appropriate treatment of deferred taxes associated with Ohio Electric Company, a subsidiary of Ohio Power whose rates had not theretofore been subject to Commission review. Secondly, whether or not one believes the issue in that case to have been correctly decided, it is quite clear from other orders addressing this subject that the Commission has viewed the controlling factor to be that these deferred amounts are not investor-supplied sources of funds, without real concern as to whether they are theoretically provided by customers or by the federal government. In fact, in the very first rate decision following statutory authorization of normalization, the Commission approved a rate base deduction (*Dayton Power and Light Company*, Case No. 76-88-GA-AIR [July 22, 1977]). Certainly there had been no actual customer "funding" of the deferrals at that time. In essence, the deferrals operate as a continuing offset to the original cost of the property with which they are associated and should be so considered for rate-making purposes. The Commission is of the opinion that Section 4909.05(I) Revised Code contemplates this type of rate base adjustment, but even if in the absence of express statutory authority we would view the staff's deduction as an appropriate and necessary adjunct to our approval of interperiod tax allocation. Applicant's objection should be overruled.

# Opinion and Order, PUCO Case No. 79-537-EL-AIR

## Rate Base Summary:

In light of the foregoing discussion, the Commission finds the jurisdictional rate base as of the date certain of June 30, 1979, to be as set forth on the following table. This table also presents the Commission findings as to rate base properly attributed to the application area and the City of Cleveland under the staff's allocation methodology which we have heretofore approved.

Rate Base Summary  
(000's Omitted)

	<u>Total Jurisdiction</u>	<u>Application Area</u>	<u>City of Cleveland</u>
Plant In Service .....	\$1,876,953	\$1,302,137	\$ 574,816
Depreciation Reserve ....	(466,049)	(323,352)	(142,697)
Net Plant In Service .....	\$1,410,903	\$ 978,784	\$ 432,119
CWIP .....	91,521	62,976	28,545
Working Capital .....	62,525	43,619	18,906
Deferred Taxes and Tax Credits .....	(79,216)	(54,514)	(24,702)
Rate Base .....	<u>\$1,485,734</u>	<u>\$1,030,866</u>	<u>\$ 454,868</u>

## OPERATING INCOME

Applicant and the Commission's staff each submitted an analysis of test-year accounts reflecting the results of operations under the company's present permanent rates. Consumers' Counsel also submitted evidence in support of proposed adjustments to the staff's findings and several intervenors have challenged certain of the results of the staff audit through their filed objections. A number of the issues presented are identical to those heard and decided in the company's last rate case (*Cleveland Electric Illuminating Company*, Case No. 78-677-EL-AIR [May 2, 1979]),

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

as are the arguments advanced in support of the competing positions. The Commission sees no purpose to be served by another detailed analysis of these same questions and, where appropriate, will merely indicate that our determination is in accord with our prior decision.

**Operating Revenue:**

The staff found applicant would have realized gross annual operating revenues of \$773,389,000 had its present permanent rates been in place throughout the test year (Staff Ex. 3, Rev. Sched. 1). Although applicant originally raised a number of issues with respect to the staff's revenue determination through its filed objections, revisions offered by the staff at hearing have served to remove most of these matters from controversy (Staff Ex. 3; Staff Ex. 4; Staff Ex. 7). The applicant and the staff now agree with respect to the annualization of fuel costs and revenues and this question requires no further review. Applicant will be directed to file base (or non-fuel) rates sufficient to compensate the company for the approved allowable expenses, exclusive of fuel costs includable under Rule 26, and yield the authorized return on rate base, based on test-year operations as analyzed herein (*Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979]).

An issue does remain, however, with respect to applicant's proposal to amortize the revenue and expense impact of a change in the demand charges contained in the contract governing purchases from Ohio Power Company (App. Ex. 1, Sched. C-3.21; App. Ex. 7A, pp. 2-3). The staff recommends against such an adjustment, pointing out that the change, which became effective January 1, 1980, is out-of-period, and that the annualization of purchased power costs, even to year-end levels, has not been considered appropriate by the Commission (Staff Ex. 7, pp. 36-37). The staff also explains that the specific change

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

in the Ohio Power contract relates to short term and limited term purchases, many of which will be recovered through the fuel adjustment clause (Staff Ex. 7, p. 37). As the Commission found in our recent decision in *Toledo Edison Company*, Case No. 79-143-EL-AIR (February 29, 1980), the month-to-month and year-to-year fluctuations in purchased power expense may occur for a variety of reasons and there is no assurance that an annualizing adjustment of the type proposed by applicant will render purchased power expense any more reflective of future conditions than reliance on the test-year figures. Further, allowable purchased power costs under the fuel adjustment clause cannot be predicted because of the multitude of complex factors which govern recovery through that mechanism. Applicant's proposed adjustment does not adequately consider this point (Staff Reply Brief, p. 8). The Commission will accept the staff's recommendation in this regard.

**Labor Expense:**

There are several issues in these proceedings which fall under the general heading of labor expense. Specifically, they involve the annualization of union wage increases, the annualization of non-union wage increases, and the annualization of overtime expense. The staff annualized union and non-union wage increases in place at the conclusion of the test year, but did not annualize the effect of any increases in the overtime rate (S.R., Sched. 3.4). Applicant annualized union wage increases through the May 1, 1980 contract, and non-union and overtime through the completion of the test year (App. Ex. 1, Sched. C-3.4). Consumers' Counsel objects to the annualization of any non-union wage increases.

The Commission has addressed each of the issues presented in a number of its recent decisions. For purposes

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

of these proceedings, we accept the staff adjustment for union and non-union increases in accordance with our decisions in this company's prior case and in *Toledo Edison Company*, Case No. 79-143-EL-AIR (February 29, 1980). We reject applicant's annualization of the May 1, 1980 increase as it does not comply with the standards for such a post-test period adjustment as set out in *Columbia Gas of Ohio*, Case No. 77-1309-GA-AIR (May 24, 1979) and *Cincinnati Gas and Electric Company*, Case No. 79-11-EL-AIR (January 7, 1980). Although the per unit rate of the increase may be known with certainty, there is no assurance that changes in number of employees, budgeted hours, and employee mix will not lead to an overstatement of the costs properly matched with that level of service and productivity experienced during the test year (See *Columbia Gas of Ohio*, Case No. 76-704-GA-CMR [June 29, 1977]). We do find, however, that applicant has satisfied the requisites of *Dayton Power and Light Company*, Case No. 79-372-GA-AIR (May 7, 1980), with respect to its proposed annualization of overtime expense, and that adjustment should be approved. Pension costs will be adjusted to reflect the above findings.

**Power Plant Maintenance Normalization:**

The applicant and the staff both adjusted power plant maintenance expenses to reflect the deferral of maintenance originally scheduled for the first half of the test year to future periods due to the extended shut-down of Davis-Besse during the second quarter of 1979 (App. Ex. 1, Sched. C-3.11; S.R., p. 14; S.R., Sched. 3.12). The staff adjustment normalized maintenance only to the extent budgeted maintenance was pushed into the second half of the test year. Applicant's adjustment recognized maintenance deferred into 1980. The purpose of this adjustment is to establish a reasonable annual allowance for

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

power plant maintenance. The Commission agrees with applicant that the staff adjustment fails to recognize the level of maintenance which would have been performed during the test year but for the unusual outage. The deferral of maintenance for the first half to the second half of the year meant that maintenance planned for the latter period had to be deferred until some subsequent time as maintenance schedules had become filled (App. Ex. 5A, pp. 22-24). Applicant's adjustment should be approved and its objection to the staff adjustment is, hereby, sustained.

**Vehicle Fuel Annualization:**

In recognition of the extraordinary increases in the cost of fuel used in company vehicles, the staff annualized vehicle fuel prices to year-end levels (S.R., Sched. 3.7). Applicant also proposes an annualizing adjustment to vehicle fuel; but would have the Commission calculate the adjustment with reference to March, 1980 price levels (App. Ex. 1, Rev. Sched. C-3.8; App. Ex. 5A, p. 21). Our earlier discussion with respect to annualizations based on post-test year data is dispositive of this issue as well. The Commission is, of course, aware that gasoline prices have continued to rise after the close of the test year. However, an annualization based on some post-test year price level ignores what the company's response to this post-test year increase might be. The matching principle may be violated. For example, in this instance applicant's witness Chopp acknowledged that the company was undertaking programs to reduce fuel consumption in an effort to offset these increased costs (Tr. II, p. 110). One would not reasonably anticipate that even the company's most stringent conservation program would totally offset the rise in prices; but the point is that there is no way to measure what the actual effects may be. Thus, although the cost

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

change may be known and measurable, an element of speculation remains. The Commission overrules applicant's objection to the staff's adjustment.

**Storm Damage and Tree Trimming Expense:**

As in applicant's prior case, the staff normalized storm damage and tree trimming expense to assure that the rates set in these proceedings would reflect a representative allowance for these items (S.R., p. 14; Staff Ex. 3, Rev. Sched. 3.13 and 3.14). The staff method, which was essentially the same as that approved in the last case, was based on an average of the annual expenses incurred for these items for the previous five years, restated to 1979 dollars. Applicant objected to the staff adjustments and offered alternative calculations based on essentially the same method rejected in the last case. Applicant contends that the staff's adjustment fails to recognize that there has been an actual increase in the amount of work being done; but the company has offered little in the way of conclusive proof that this alleged increase has, in fact, occurred (Staff Reply Brief, p. 14). Consistent with our decision in applicant's prior case, the Commission again finds the staff adjustments to be proper.

**Ordered Load Research Expenses:**

Applicant proposed an adjustment to test-year expenses to reflect costs associated with load research activity it is compelled to engage in under the provisions of the Public Regulatory Policies Act of 1978 (App. Ex. 1, Sched. C-3.10). The staff recommends that this adjustment be rejected (S.R., p. 18). This expense of \$72,084 relates to certain load meters which applicant leased after the close of the test year. The staff's opposition to the adjustment is based not only on the fact that no costs were incurred in the test year, but also on its observation that while the transaction is treated as a lease for purposes of this adjust-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

ment, it will be treated as a purchase and capitalized when the property is actually acquired (S.R., p. 14). The Commission agrees that the adjustment should be disallowed.

**Advertising Expense:**

The staff reviewed the advertising expenses included in applicant's test-year operating expenses and concluded that no adjustment was required based on its view that the company's advertisements conformed to Commission guidelines and PURPA standards (S.R., p. 15). However, at hearing, Consumers' Counsel and Senior Citizens, *et al.*, presented a series of exhibits which contained the copy of advertisements placed in various media by the Illuminating Company during the test year (O.C.C. Ex. 6; Senior Citizens Ex. 11). These adds are clearly promotional and of no benefit to the consumers. In general, the only information they impart is a general observation that although the cost of service has risen over the years, electricity still represents a good value. As calculated from exhibits indicating the test-year expense associated with these ads, their jurisdictional cost was \$238,617 (O.C.C. Ex. 7, Senior Citizens Ex. 12). This amount should be eliminated from allowable expenses. The Commission can anticipate applicant's objection to this adjustment. It will be based on the argument that no witness offered testimony that the advertising was promotional in nature or did not benefit consumers. Our response will be borrowed from another source. We know it when we see it.

**Charitable Contributions:**

As fully explained in the Commission's decision in the company's last rate case, the Illuminating Company does not generally contribute directly to charity, but makes its donations through the vehicle of the CEI Foundation. However, in the course of its investigation the staff did discover some \$18,352 that the company had charged to

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

jurisdictional operation and maintenance expense which the staff believed should be reclassified as a charitable contribution (S.R., p. 15; S.R., Rev. Sched. 3.17). Applicant explained that it had elected to treat this amount as an expense for fear that if it made the donations through the CEI Foundation it could be subjected to penalties if the IRS perceived an indirect benefit to the company (App. Ex. 5A, p. 25; Tr. II, p. 115). The Commission is not particularly concerned as to what treatment the company accords this amount for tax purposes; but for ratemaking purposes it is clear that it should be considered as a charitable contribution. Applicant's objection to the reclassification is overruled.

This Commission has consistently approved a reasonable allowance for charitable contributions in its cost of service analyses and was prepared to do so again in these proceedings. However, the opinion just issued by the Supreme Court in *City of Cleveland v. Public Utilities Commission*, S.Ct. Case Nos. 79-1158 and 79-1173 (July 9, 1980), 63 Ohio St. 2d(1980), quite clearly reverses the Court's recent decision in *City of Cincinnati v. Public Utilities Commission*, 55 Ohio St. 2d 168 (1978), which specifically approved this long-standing Commission practice. In accordance with this new decision, the Commission now finds that the intervenors' objections to any allowance for charitable contributions should be sustained. As the Commission would have accepted the staff's method of calculating an allowance for charitable contributions as we did in the prior case, the effect is to reduce allowable expenses from what we would have otherwise determined by the amount of \$492,539 (S.R., Sched. 3.18).

**Rate Case Expense:**

Contrary to customary practice, the company did not propose an allowance for expenses incurred in connection with these proceedings in its cost of service analysis.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Rather, applicant elected to rely on the rate case expenses actually charged to its books during the test year on the theory that it will be filing such cases on an annual basis (App. Ex. 5A, pp. 26-27). The staff did obtain an estimate of the costs anticipated by applicant in connection with these proceedings (App. Ex. 1, Sched. C-9), made a determination that the estimate was reasonable, and recommended that the estimated expense be amortized over a two-year period. Thus, the staff's proposed allowance is \$174,000 (S.R., Sched. 3.19). Upon review of the record relative to this subject, the Commission believes the staff's proposed allowance should be accepted. The bulk of the rate case expense incurred by applicant during the test year related to its prior case. As a theoretical matter, expenses associated with the prior case should not be built into the rates authorized in these proceedings. Moreover, the Commission is concerned that applicant's proposed method of dealing with this subject may make our review of the reasonableness of these expenditures more difficult. With due regard for our prior observations concerning the nature and purpose of the rate case expense allowance, the Commission sees no reason to depart from our usual practice with respect to this item (See, *e.g.*, *Columbus and Southern Ohio Electric Company*, Case No. 77-545-EL-AIR [March 31, 1978]).

Intervenor City of Cleveland objects to the staff's proposed allowance for rate case expense and a considerable portion of this record is devoted to its attack on the reasonableness of the staff's finding. This onslaught was then broadened to include the question of legal fees in general. Despite the pages of transcript generated by the City of Cleveland's efforts in this regard, there is not one iota of affirmative evidence that the rate case expense allowance is unreasonable or that applicant's practices with respect to retaining legal counsel are inconsistent with that which should be expected from a major corporation

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

(Tr. XXXI). Further, intervenor never suggested, either through a witness or on brief, what it considered to be reasonable with respect to these areas. All the Commission is left with are its bare assertions that the amounts proposed by the applicant and the staff are not. These objections should be overruled.

**PUCO Maintenance Tax and Consumers' Counsel  
Assessment:**

Although it has been the consistent practice of the Commission, applicant objects to the staff's classification of the PUCO maintenance tax and Consumers' Counsel assessment as "other taxes", contending that the Uniform System of Accounts requires that they be charged to operation and maintenance expense (App. Ex. 5A, p. 24). The significance of this issue is, of course, the effect on the working capital calculation. On brief, staff counsel argues that the accounting requirements are not as clear cut as applicant would have us believe and points out that applicant is one of the few utilities that does not account for these items as taxes (Staff Reply Brief, p. 11). Neither of these arguments need detain us, for no matter what method the company elects to employ for bookkeeping purposes, the Commission would still consider the assessments as taxes for ratemaking purposes. Applicant's objection to the staff's classification is overruled, as is its objection that these amounts should be allocated, a matter decided in the company's last case.

**Pennsylvania Public Utility Realty Tax (PURTA):**

Pennsylvania has enacted a public utility realty tax which significantly increased applicant's tax obligation in that state commencing with the 1979 tax year. As a part of this new law, the Pennsylvania legislature also imposed a one-time surcharge, in applicant's case amounting to approximately \$1.4 million, which the company paid dur-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

ing the test year. Although both the applicant and the staff recognized the PURTA tax in their calculation of allowable expenses, the staff eliminated the surcharge payment from its cost of service determination (S.R., p. 17; S.R., Sched. 3.24e). Applicant objects to the staff adjustment.

The Commission has had occasion to consider this precise question in its recent decisions in *Ohio Edison Company*, Case No. 78-1567-EL-AIR (January 30, 1980) and *Toledo Edison Company*, Case No. 79-143-EL-AIR (February 29, 1980). Consistent with those decisions, the Commission again concludes that the staff adjustment is, in all respects, reasonable and proper and should be approved. No one disputes that this one-time surcharge is a nonrecurring expense. As such, it should not be reflected in future rates, and applicant's now familiar arguments to the contrary must, accordingly, be rejected. There is no merit in the claim that this nonrecurring expense should be allowed in recognition of the possibility that there may be other nonrecurring expenses in the future, nor is their merit in the theory that disallowing the expense will encourage state legislatures to view the mechanism of a surtax as a source of "free money" (App. Ex. 5A, pp. 30-32). The risk that there will be unanticipated expenses in the future is a risk assumed by the investor when he purchases the company's securities. Indeed, the investor's assessment of this risk plays a big part in establishing his return requirements. Further, a state legislature which intentionally pursued the course hypothesized by applicant would either effectively render what was nominally a one-time surcharge a recurring expense deserving of rate recognition, or would create a climate which would ultimately result in increased investor requirements relative to the affected utilities. Those increased requirements would, in time, lead to increased rates.

On brief, applicant submits that its property "is simply confiscated" by the exclusion of this item from cost of service (App. Brief, p. 16). This is nonsense. As this Com-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

mission has repeatedly pointed out, the purpose of rate regulation is not to guarantee the dollar-for-dollar recovery of specific past expenses, but rather to determine a representative allowance for expenses which will provide a reasonable future earnings opportunity (See *e.g.*, *Ohio Edison Company*, Case No. 77-1249-EL-AIR [November 17, 1978]). Applicant suggests that the Pennsylvania legislature imposed this surcharge in order to retain monies collected during the pendency of a challenge to an earlier version of the PURTA tax which eventually resulted in the tax being overturned. (See *Commonwealth v. Philadelphia Electric Co.*, 472 Pa. 530 [1977]). This points up the very reason nonrecurring costs are not considered in fixing future rates. Assume for purposes of discussion that the court decision had been adverse to utility interests and that the tax had not theretofore been considered for rate-making purposes. The fact that applicant loses sight of in its "confiscation" argument is that building a mechanism for recovery of the surcharge into future rates would have absolutely no effect on the company's 1979 financial performance. The Commission has not denied applicant an earning's opportunity. The expense is history and has no place in the establishment of future rates.

**Federal Income Tax:**

Through its filed objections, applicant originally took exception to a number of aspects of the staff's federal income tax calculation. Most of these objections were tied to other staff expense adjustments and are now resolved. Of those that remain, applicant pursued only the investment tax credit amortization question on brief. The treatment the staff accorded this item is in keeping with that approved in prior Commission cases, and is the balance of the staff's method. The staff's calculation of federal income tax expense should be accepted for purposes of these proceedings.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR****Terminated Generating Units:**

By an amendment to its original application, applicant seeks Commission approval of an adjustment to allowable expenses which would permit the company to recover its share of the costs associated with the termination of four nuclear generating units pursuant to the CAPCO decision of January 23, 1980, that Davis-Besse No. 2 and No. 3 and Erie Nuclear Unit No. 1 and No. 2 should be cancelled. Applicant's specific proposal is that the expenses incurred to date for these projects, \$56,437,000, be adjusted to reflect necessary tax considerations and amortized over a ten-year period (App. Ex. 4A, p. 22; App. Ex. 1, Sched. 3.22). The staff recommends approval of the adjustment (Staff Ex. 11, pp. 18-20; Staff Ex. 7, pp. 37-40). Consumers' Counsel and intervenors City of Cleveland and Senior Citizens, *et al.*, object to any recognition of these termination costs in the rates to be established in these proceedings.

As a preliminary matter, the Commission must first take up intervenors' claim that this issue is not properly before the Commission as the adjustment was not proposed until after the notice of the rate request required by Section 4909.18 Revised Code had been published. The Commission disagrees with these arguments, noting that statute only contains the requirement that "the substance of the application" be noticed. Because applicant did not propose any specific increase in the actual rates requested, the substance of the application is unaffected by this later adjustment to the supporting data. Had the proposal predated the notice, there would certainly have been no requirement that it be included in the publication.

The real threshold question here, which the Commission perceives as the most difficult of all the issues raised in connection with this matter, is whether this adjustment is legally permissible. In reviewing all the available cases considering cancellation costs from both state and federal

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

regulatory jurisdictions, we find the most surprising feature to be, not the fact adjustments of this type have been approved without exception, but that there is no hint that this legal question was ever even raised (App. Ex. 4A, p. 69). At first blush, one would think that the risks of cancellation should be borne solely by the investor; however, applicant's arguments persuade us that this is not the case (App. Brief, pp. 8-15). Intervenor approach this issue as though it were a rate base question, emphasizing the fact that the terminated units have never and will never provide service to customers. This is quite clearly correct, but it is irrelevant. There is no request by the company that it be permitted to earn a return on this investment, although some jurisdictions have permitted this treatment. What the company seeks is the recovery of costs incurred on behalf of its ratepayers to assure that adequate service could be maintained (Tr. XXI, p. 185). The significant question, given the Commission's past pronouncements with respect to the impropriety of the recovery of past losses through future rates, is whether the amortization of these extraordinary costs does violence to this principle. The distinguishing feature that sets this adjustment apart from those we have rejected on this ground in the past is that costs associated with the termination of the units did not really become costs until the fact of termination. Cancellation does not create a past loss, but gives rise to a current cost. Unlike the PURTA surtax issue discussed earlier, where approval of the proposed adjustment would have had no effect on the company's future earnings opportunity, rejection of this adjustment would have a very direct impact on applicant's financial performance as, in the absence of funding of the amortization through rates, applicant would be required to write off these costs currently (Tr. XXII, p. 49). Thus, we now see the wisdom of the standard emerging from the cases from other jurisdictions; if the expenditures are prudent, amortization should be permitted.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

In determining whether these expenditures were prudent, one must bear in mind what is and what is not at issue. No one disputes that the 1973 decision to embark on the construction in question was reasonable as it was based on the best data available (App. Ex. 11; App. Ex. 29; Staff Ex. 11). Similarly, no one disputes that the decision to terminate construction was reasonable, given the intervening decline in growth expectations and the uncertainties which now attend the construction of nuclear units. Thus, the only real question is whether the decision to terminate should have been made sooner. Applicant's witness William described in detail the company's response to changes in growth rates, including postponements of units so that in-service dates would better match the results of new load forecasts (App. Ex. 11, p. 30). Only Consumers' Counsel witness Rosen offered testimony suggesting that the units should have been cancelled earlier (O.C.C. Ex. 5), and his opinion is of doubtful value as it is based solely on CAPCO information and does not specifically address any of the considerations which may have influenced this applicant's decisions (Tr. XXVIII, p. 115; Tr. XXIX, pp. 19-21). Further, the alternative construction program he now recommends for CAPCO, which involves an unbelievable reliance on oil-fired peaking units, casts doubt on the credibility of his entire study, even if it were found to have any application in this case. The Commission finds that applicant's decisions were reasonable and prudent at every step of this process, and concludes that the proposed adjustment should be approved. For purposes of these proceedings we accept the staff's method of calculating the adjustment (Staff Ex. 3; Sched. 3.0).

**Operating Income Summary:**

Consistent with the foregoing discussion, the Commission finds applicant's jurisdictional adjusted operating income for the twelve months ending December 31, 1979,

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

the test period in these proceedings, to be as set forth on the schedule below. Although revenues can be directly assigned to the application area or the City of Cleveland, expenses must be allocated. The following schedule also depicts the results of the application of the staff's proposed expense allocation factors which the Commission has accepted as reasonable for purposes of these proceedings:

**Adjusted Operating Income**  
(000's Omitted)

	<u>Total Jurisdiction</u>	<u>Application Area</u>	<u>City of Cleveland</u>
<b>Operating Revenues</b> .....	\$773,389	\$542,489	\$230,900
<b>Operating Expenses</b>			
Operation and Maintenance .....	\$471,852	\$330,775	\$141,077
Depreciation Expense .....	61,277	43,342	17,935
Taxes Other Than FIT .....	76,194	53,163	23,031
Federal Income Tax .....	39,355	28,227	11,128
<b>Total Operating Expenses</b> .....	<u>\$648,678</u>	<u>\$455,507</u>	<u>\$193,171</u>
<b>Net Operating Income</b> .....	<u>\$124,711</u>	<u>\$ 86,982</u>	<u>\$ 37,729</u>

**PROPOSED INCREASE**

A comparison of jurisdictional operating revenues of \$773,389,000 with the allowable jurisdictional expenses of \$648,678,000 indicates that under its present permanent rates applicant realized income available for fixed charges in the amount of \$124,711,000 based on adjusted test-year operations. Applying this dollar return to the jurisdictional rate base of \$1,485,734 results in a rate of return under present rates of 8.39 percent. Current rates to customers in the application area produced test-year income available of \$86,982,000, which, when applied to the allocated rate base of \$1,030,866, yields a rate of return of 8.44 percent. Present rates to customers in the City of Cleveland, which

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

are the same as those contained in the ordinance complained of, resulted in adjusted test-year net operating income of \$37,729,000. This dollar return, when applied to the rate base properly allocable to the City of Cleveland of \$454,868,000, produces a rate of return of 8.29 percent. All these rates of return are well below that recommended as reasonable by any of the expert witnesses testifying on this subject and the Commission must, therefore, find that the company's present rates are insufficient to provide it reasonable compensation and return for the electric service it renders. Moreover, Ordinance No. 1673-79 of the City of Cleveland, which would continue these rates in effect in that municipality, must also be found to be unreasonable. Rate relief is clearly required, and the ordinance complained of must be modified.

Under the rates proposed by applicant, additional gross annual revenues of \$79,795,000 would have been realized based on test-year operations as analyzed herein (S.R., Sched. 1). On a pro forma basis, which assumes necessary expense adjustments calculated in a manner consistent with the Commission's findings, this proposed increase would have yielded an increase in jurisdictional net operating income of \$41,301,000 resulting in income available for fixed charges of \$166,012,000. Applying this dollar return to the jurisdictional rate base results in a rate of return of 11.17 percent. Net operating income for the application area would be increased to \$116,008,000 under the proposed rates, resulting in a rate of return on the rate base allocated to this service of 11.25 percent. For the City of Cleveland, the proposed increase produces pro forma income available of \$50,004,000 and a rate of return on rate base of 10.99 percent. Although these rates of return are supported by the opinions of applicant's rate of return witnesses, the jurisdictional rate of return under the proposed rates is above the range recommended as reasonable by the staff witness testifying on this subject. The existing rates

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

are inadequate; but further examination is necessary before a final determination as to the level of rate relief required can be made.

**RATE OF RETURN**

Three witnesses offered cost of capital analyses to be considered as evidence by the Commission in establishing a fair rate of return for purposes of these proceedings. The study sponsored by applicant's witness Jeffries concludes that a rate of return of from 11.17 to 11.55 percent is appropriate (App. Ex. 8A, p. 8), and applicant's witness Maugans proposes a nearly identical range (App. Ex. 4A, p. 64). Witness Farrar, testifying on behalf of the staff, determined the overall cost of capital to be between 10.65 and 11.02 percent (Tr. XXIV, pp. 4-5). Although the difference between the company and staff positions lies primarily in the area of the cost of common equity, there are certain other minor issues which the Commission must first address.

**Capital Structure:**

Each of the witnesses employed the company's December 31, 1979, capital structure in their respective cost of capital analyses. The use of a capital structure which reflects post-date certain developments has been approved by the Commission in a number of recent decisions in an effort to better recognize the cost of capital to the applicant utility which will prevail in the period for which rates are being set. (See, e.g., *Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979] and *Ohio Edison Company*, Case No. 78-1567-EL-AIR [January 30, 1980]). Consistent with those decisions, the Commission finds the use of the December 31, 1979, capital structure to be appropriate. The specific ratios, as calculated by Mr. Farrar, are 46.57 percent long-term debt, 15.01 percent preferred stock, and 38.41 percent common equity (Staff Ex. 11,

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

p. 21). These percentages differ slightly from those computed by applicant due to the fact that the staff and the applicant used different techniques to adjust for a loss experienced by the company in connection with a reacquisition of preferred stock in 1978 (Staff Ex. 11, p. 3). As applicant acknowledges on brief, the difference in the result is not significant (App. Brief, p. 35). Accordingly, we accept the capital structure proposed by Mr. Farrar as reasonable for purposes of these proceedings.\*

**Cost of Debt and Preferred Stock:**

Each of the rate of return witnesses testifying in these proceedings derived the costs to be assigned the debt and preferred stock components of applicant's capital structure by reference to the actual embedded costs of these senior securities. Despite the fact that its own expert witness specifically testified to the contrary (Tr. XVII, pp. 72-73), applicant continues to suggest, as it did in its filed objections, that the use of embedded costs for this purpose is unreasonable and unlawful (App. Brief, p. 35). Although we agree with applicant that a determination of this issue is certainly not essential in this case, the Commission believes it appropriate to lay this theory to rest at this time.

Section 4909.15(D)(2)(a) Revised Code now requires that the Commission determine a fair and reasonable rate of return for an applicant utility with reference to the

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\* Although he presented no independent rate of return recommendation, Consumers' Counsel witness Larkin suggested that the Commission should recognize short-term debt in the capital structure utilized in the cost of capital analysis (O.C.C. Ex. 2, pp. 5-8). Such a step would be inconsistent with Commission precedent and contrary to the specific recommendations of the other witnesses; however, the Commission need not reach this question as Consumers' Counsel has, on brief, now indicated its support of the use of the staff's capital structure for purposes of these proceedings (O.C.C. Brief, p. 4).

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

embedded cost of debt of the utility in question. As anyone familiar with the 1976 changes in Ohio's ratemaking statutes can attest (Am. Sub. S.B. 94), this provision was inserted in response to the decision of the Supreme Court of Ohio in *Cleveland Electric Illuminating Company v. Public Utilities Commission*, 42 Ohio St. 2d 403 (1975), wherein the Court apparently held that the then-existing statutory framework required that the Commission employ the current cost of debt in its rate of return determination. However, even before the legislative reversal of the *Cleveland Electric Illuminating Company* decision, *supra*, the Commission, in its Entry on Rehearing in *Cincinnati Gas and Electric Company*, Case No. 72-415-Y (October 17, 1975), undertook a careful analysis of the existing precedent which let it to the unanimous conclusion that the use of embedded costs was both theoretically appropriate and legally permissible. We commend this discussion to applicant's attention and point out that its logic is even more compelling now that Ohio rate regulation no longer even arguably involves the fictional reproduction of rate base at date certain.

Applicant contends that even if Section 4909.15(D) (2)(a) Revised Code now specifically requires consideration of the embedded cost of debt in the rate of return determination, the silence of the statute with respect to preferred stock should be construed as evidence of a legislative intent that current costs be employed in connection with this capital component. Although the Commission does not take issue with the principle of construction cited by applicant, the result produced by its application in this setting is so unreasonable that we do not believe it can logically be invoked. As suggested above, a review of the history of this provision clearly indicates that it was enacted to overturn a specific judicial decision, not as a directive to the Commission to alter its consistent practice of relying on embedded costs as the best evidence of the

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

appropriate cost rates to be assigned the long-term debt and preferred stock components of the capital structure. The Commission's discussion of the embedded cost question in *Cincinnati Gas and Electric Company*, *supra*, in dispositive of this issue as well. Even in the days of the RCNLD rate base, it was a rare exception when a utility rate of return expert proposed the use of anything other than embedded costs in his determination of the weighted cost of senior securities; and the Commission has certainly never been treated to testimony exclusively advocating current costs for these capital components since Ohio became an original cost jurisdiction.

As indicated above, the Commission has accepted the capital structure proposed by staff witness Farrar. We now further find Mr. Farrar's determination of the embedded cost of debt, 8.19 percent, and preferred stock, 8.30 percent, to be reasonable and adopt same for purposes of the analysis in these proceedings (Staff Ex. 11, p. 3).

**Cost of Common Equity:**

Determining the cost of debt and preferred stock is, and as explained above, should be largely a mechanical process. The cost of common equity, however, can only be estimated. As the Commission has noted on a number of prior occasions, a variety of valid methods exist for obtaining this estimate, and the fact that the Commission selects the recommendation of one witness over that of another does not mean that any of the recommendations are "wrong," save in those instances where internal inconsistencies render a particular recommendation unacceptable even under the sponsoring witness's own approach. The Commission must, in a necessary exercise of its judgment, select that recommendation it believes to be most reasonable in light of the facts and circumstances of a given case. This task is made even more difficult in this case due to the radical changes in financial conditions experienced from the outset

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

of the test year through the present time. Indeed, these changed circumstances have prompted each of the witnesses offering testimony on the cost of equity to revise his recommendation.

In his original testimony, filed in September of 1979, applicant's witness Jeffries recommended a return on common equity of from 15.0 to 16.0 percent (App. Ex. 8, p. 30). The range he proposes in the supplemental testimony submitted just prior to hearing is 16.00 to 17.00 percent (App. Ex. 8A, p. 2). Applicant's witness Maugans originally suggested as reasonable a rate of 15.5 percent (App. Ex. 4, p. 70). He now supports Mr. Jeffries' revised recommendation (App. 4A, p. 1). As set forth in the staff report, the staff's original position was that the appropriate cost of equity was in the range of 14.01 to 14.94 percent (S.R., p. 27). At hearing, witness Farrar adjusted this recommendation to reflect more current data and concluded the proper cost of equity was between 14.56 and 15.52 percent (Tr. XXIV, pp. 4-5).

Mr. Jeffries employed several methods in arriving at his original recommendation. He performed a comparable earnings test involving a review of the return on common equity achieved over the past ten years by sixteen electric utilities with bond ratings the same as that of the applicant (App. Ex. 8, pp. 20-21; App. Ex. 8, p. 6; Tr. XVII, p. 29). Based on this analysis, Mr. Jeffries concluded that a rate of return on common of 15.00 percent would be appropriate. In evaluating this recommendation, the Commission observes that at no time in the past ten years has the average return of the sixteen companies studied ever reached 15.00 percent. In fact, in the years since 1974, the year of the oil embargo and general business recession, the achieved return for this group has been well below this figure. In both 1978 and 1979 it was 13.2 percent. Mr. Jeffries explained that in arriving at his recommended return based on this evidence he gave consideration to

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

recently granted and pending rate increase requests (App. Ex. 8, p. 20); however, the effect of these increases was never quantified.

The disparity between the actual data and the witness' recommendation based on that data is not surprising. Indeed, this discrepancy highlights one of the shortcomings of the comparable earnings method which the Commission has identified in the past (*Columbus and Southern Ohio Electric Company*, Case No. 77-545-EL-AIR [March 31, 1978]). Where the members of the group examined for comparative purposes exhibit depressed market-to-book ratios, a vicious circle will be created if their achieved returns are relied on by regulators in determining the rate of return to be authorized in a given case. On the other hand, the logic of the method breaks down if one first looks to the experience of the group defined as comparable, concludes that the experience is not really suitable as evidence under existing conditions, and then, through an exercise of judgment, attempts to establish a return requirement based on a perception of what the group should be earning. This is not to say that the Commission should totally discount the experience of other comparably-rated electric utilities, but merely to point up the fact that the witness has used a good deal of judgment in deriving an equity return recommendation of 15.00 percent from data which, on its face, would apparently support a much lower number.

Mr. Jeffries also looked to the rate of return on common equity of Standard & Poor's 400 Industrials over the past ten years as a basis for his recommendation (App. Ex. 8, p. 21; App. Ex. 8, p. 30; App. Ex. 8, p. 39). He concluded from an examination of the average return earned by this group in the years 1976 through 1978 that a range of 14.50 to 15.20 percent could be supported, and also indicated that in 1979 the experienced return had jumped to 16.90 percent (Tr. XVII, p. 36). The witness included this broad

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

industrial composite on the theory that the member companies represent alternative investment opportunities and that applicant must compete for funds with these firms in the money market. Although this evidence may be of some value from the standpoint of providing a broad overview, the Commission does not believe it appropriate to predicate a return recommendation on the experience of this large, diverse group, particularly without any detailed analysis of the characteristics of its members. The cornerstone of the alternative opportunity cost concept upon which the comparable earnings method is based is that the return authorized should be commensurate with returns being earned on investments in other business undertakings having similar or corresponding risks, but should not be so high as the returns which might be realized from highly profitable enterprises or speculative ventures. *Bluefield Waterworks Company v. Public Service Commission*, 262 U.S. 679 (1923). Thus, there must be a showing that the enterprises selected for comparative purposes are, in fact, comparable. There has been no such showing in this case, and the Commission can accord little weight to a return recommendation based on this data.

A comparable earnings approach was also employed by Mr. Jeffries in connection with his efforts to emphasize the importance of fixing a rate of return on common equity which will allow the company to attract capital on the most reasonable terms possible (App. Ex. 8, p. 24). Although applicant's bonds are still rated double-A by Moody's, they have been recently downgraded by Standard and Poor's to AA- (App. Ex. 8, p. 24). The company lost its double-A preferred stock rating in 1976 (App. Ex. 8, p. 28). As an improvement in the current ratings would result in lower financing costs to the company, the witness deemed it appropriate in recommending a rate of return on equity to evaluate the achieved return of electric utilities with double-A ratings for both preferred stock and bonds (App. Ex. 8, p. 43). This reduced the number in

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

the original group studied from sixteen to twelve. The resulting average return is slightly higher during the years since 1974 than the average return for the larger sample, with the exception of 1979 when it was actually lower. In no event, however, did this average return approach 15.0 percent, the lower bound of the witness' equity return recommendation. There is no need to repeat our earlier comments with respect to the inherent problems in the comparable earnings approach, but an additional observation is in order. There is much more involved in solidifying or improving applicant's present ratings than merely handing out rate increases, as company witness Maugans acknowledged (Tr. X, pp. 54-68; Tr. XII, pp. 164-166). Adequate rate relief is an important step, but utility management also has a definite role to play as it is the company's performance over time that influences the rating agencies. The Commission recognizes that improved ratings will lead to lower future financing costs, but the real question is what price we should ask the consumers to pay presently for this future benefit. This is the very heart of the rate of return inquiry, and a balance must be struck. Were it not for this consideration, we could simply send the rate of return witnesses home and decide the earnings requirement question solely through an analysis of coverage ratios. There is quite clearly more to establishing a reasonable earnings opportunity than a mechanical calculation designed to satisfy the rating agencies' coverage tests.

As a fourth measure of the appropriate return on common equity, Mr. Jeffries performed a risk premium analysis involving a comparison of the yield on new double-A rated utility bonds with the return on equity of double-A rated electrics for the years 1964 to 1978. The average equity-debt risk spread for the period was 5.91 percent (App. Ex. 8, p. 43). He then applied this risk spread to the average yield on newly issued bonds of similar rating for the twelve months ended August, 1979, which he calcu-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

lated to be 9.6 percent (App. Ex. 8, p. 29). Summing the two numbers produced an indicated return on common equity of 15.51 percent. Staff witness Farrar, who also performed a risk premium analysis as a check on the reasonableness of his own cost of equity recommendation (S.R. 29, pp. 29-30), criticized Mr. Jeffries' use of achieved returns on common equity for purposes of establishing the annual differential (Staff Ex. 11, pp. 11-12). He argued that the use of achieved returns is improper as achieved returns do not necessarily reflect the actual cost of equity. The Commission notes that in the earlier years of the study, where the annual differential was the greatest, utility stocks were commonly sold above book value. This certainly lends support to Mr. Farrar's contention that the average risk spread employed by Mr. Jeffries is too high. However, even based on Mr. Jeffries' own method of calculation, we observe that the annual differential reached the average for the period only once in the 1970's and that was in 1972. If one limits the historical time frame of the analysis to what is clearly a more representative period in terms of future expectations, say 1975 through 1978, one gets far different results. Using Mr. Jeffries' numbers, the average equity-debt risk spread for the more recent period is 3.74 percentage points. Combining this risk premium with the 9.6 percent referred to above produces an indicated rate of return on common equity of 13.34 percent, a far cry from the 15.51 percent derived by Mr. Jeffries through his methodology but an extraordinarily good match with the 1979 data utilized in his comparable earnings test. Moreover, a risk differential of 3.74 percentage points exceeds that determined by Mr. Farrar who, it will be remembered, based his calculation on an estimate of the cost of equity rather than the realized return on equity. This effectively answers the charge that the risk premiums is understated during more recent years due to insufficient achieved returns (App. Ex. 8, p. 29).

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

Mr. Farrar had the benefit of final figures for calendar 1979 at the time he performed his original analysis (S.R., p. 30). At hearing, Mr. Jeffries updated his calculation of the average monthly yield on new double-A rated utility bonds to take into account the balance of the test year. His determination of the yield, 10.48 percent, exceeds slightly that calculated by Mr. Farrar as he limited his study to new issues. However, if we accept Mr. Jeffries number for the purpose at hand, and combine 10.48 percent with a risk premium of 3.74, the indicated return on common equity becomes 14.22 percent. Again, this is well below the witness's recommended range, but does fall well within the bounds of the staff witness's original recommendation.

The final method employed by Mr. Jeffries in arriving at his original recommended cost of equity was what he characterized as a "market based" approach (App. Ex. 8, pp. 22-23). Indeed, this is a version of the discounted cash flow analysis (DCF) familiar to the Commission and consistently approved by it in the past as an appropriate means of measuring investor expectations. Under his application of the method, Mr. Jeffries concluded that the base line cost of equity was 14.50 percent. He then adjusted this cost by 10 percent to recognize issuance costs, market pressure, and dilution (App. Ex. 8, p. 23). This produced a recommended return on equity of 15.95 percent.

Staff witness Farrar also based his cost of equity recommendation on a DCF analysis. As detailed in the staff report, he determined the base line cost of equity to be 13.58 percent (S.R., pp. 28-29). Applying the staff's customary adjustment factors of 1.032 and 1.10 to this base line costs resulted in an indicated cost of equity of from 14.01 to 14.94 percent.

Given our reservations with respect to the conclusions drawn by Mr. Jeffries from the other methods he employed, it is apparent that our decision as to the appropri-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

ate return on equity comes down to a choice between Mr. Jeffries' and Mr. Farrar's DCF recommendations. Although applicant's witness Maugans also initially offered a cost of equity recommendation, his supplemental testimony relating to this area is largely devoted to a criticism of Mr. Farrar's analysis, and specifically accepts as fair the revised recommendation of Mr. Jeffries (App. Ex. 4A, p. 1). In light of this development, the Commission sees no purpose to be served by picking our way through Mr. Maugans' original proposal. We would note, however, that the testimony of Mr. Farrar raised significant questions as to the reasonableness of his methods (Staff Ex. 11, pp. 12-14).

Before considering the specifics of the competing positions of the applicant and the staff as to the proper application of the DCF formula for purposes of these proceedings, the Commission feels compelled to address certain charges contained in applicant's brief relative to the Commission's reliance on this method. Applicant apparently entertains the suspicion that the Commission's preference for the DCF approach is based on a belief that it is less subject to the vicissitudes of an individual witness's judgment than are other recognized methods (App. Brief, p. 36). This is simply not true. The Commission's general acceptance of DCF-based equity cost recommendations is grounded in the fact that DCF, by design, is a market measure of investor requirements, the very factor which must be isolated in determining the cost to the company of equity capital. The Commission has never intended to suggest that the application of the DCF formula is a mechanical process, as a review of our recent orders relative to this subject will bear out. (See, e.g., *Cincinnati Gas and Electric Company*, Case No. 79-11-EL-AIR [January 7, 1980]; *Toledo Edison Company*, Case No. 79-143-EL-AIR [February 29, 1980]). Moreover, although the Commission has relied heavily on the DCF method in

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

the past, we have never intended to suggest that it is the only acceptable method for determining the cost of equity capital.

The DCF method is based on the premise that the cost of equity capital is equal to the sum of the current dividend yield and the rate of growth in dividends (S.R., pp. 47-50). Dividend yield is, of course, determined by dividing the common stock dividend by the price. Mr. Jeffries, who for purposes of his original testimony was limited to data available through August, 1979, calculated dividend yield to be 10.5 percent based on a dividend of \$1.92 per share and an average market price of applicant's common stock of \$18.25 for the then most recent twelve month period (App. Ex. 8, p. 22). Mr. Farrar, who had calendar 1979 data available at the time of his original study, determined the yield to be 11.33 percent based on a \$2.00 dividend and a twelve-month average price of \$17.65 (S.R., p. 29). Thus, the methods for determining yield were identical, both witnesses specifically agreeing that the use of a twelve-month average price was appropriate (App. Ex. 8, p. 22; Staff Ex. 11, p. 14). We will defer consideration of applicant's apparent change in position with respect to this component of the formula for our discussion of the revised recommendations of the witnesses.

The critical difference in the DCF methodology as applied by Mr. Jeffries and Mr. Farrar lies in their respective estimates of the proper value of the growth component of the formula. Mr. Jeffries estimated growth by computing annual growth rates for common stock book value, earnings per share, and dividends for the period 1968 through 1978: 4.7 percent, 3.2 percent, and 3.6 percent, respectively (App. Ex. 8, p. 41). He then assumed that earnings growth should receive less weighting than the other two elements when forming a judgment with respect to a future growth rate, and concluded that a 4.0

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

percent growth factor was reasonable (App. Ex. 8, p. 23). Mr. Farrar, on the other hand, estimated growth by use of the "b x r" approach, "b" equalling the retention rate of earnings, and "r", the earnings on the common equity funds retained (S.R., p. 29). Based on his review of the results of the "b x r" calculation for several different periods, his observations concerning the relationship between earnings and dividend growth, and the inferences he drew from the recent increase in yield of the company's common stock, he recommends a 2.25 per cent growth factor.

Applicant's witness Maugans was highly critical of Mr. Farrar's growth estimate, claiming his reliance on the "b x r" result for a two-year period represents a complete departure from the customary staff practice of analyzing at least five years data as a basis for this calculation (App. Ex. 4A, pp. 7-12). Mr. Maugans goes so far as to suggest that Mr. Farrar selected only the numbers he needed to produce an artificially low equity cost (App. Ex. 4A, p. 8). He points out that had Mr. Farrar used the method sponsored by the staff in the company's prior case (Case No. 78-677-EL-AIR), a growth rate of 3.73 percent would result (App. Ex. 4A, pp. 10-11). He also presented an exhibit depicting the growth component which would be produced by applying the method described in the staff reports issued in twelve other electric rate proceedings to Illuminating Company data (App. Ex. 4L). These fall generally in the area of 3.5 percent. The Commission believes that Mr. Maugans' criticisms are unwarranted, that his insinuations are improper, and that his comparisons are largely irrelevant.

It must be remembered that the "growth" element of the DCF formula is actually "expected growth" and, as such, is not susceptible to empirical measurement (S.R. p. 28; Tr. XXIV, p. 26). Thus, a witness must rely on judgment in making this growth determination, and different

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

witnesses may have legitimate differences of opinion as to what constitutes the best evidence upon which to base that judgment. Moreover, the same witness may quite properly reach a different conclusion as to what evidence represents the most reliable guide to future growth prospects in two different cases, based on the facts of each case. The Commission finds nothing untoward in the fact that Mr. Farrar chose to regard different data sets as more pertinent for purposes of his recommendation in these proceedings than those which other staff witnesses have drawn upon for growth estimates in other cases. The Commission readily concedes that the staff has never used less than a five year "b x r" for determining expected growth, although it is also evident from applicant's exhibit that the staff has, in fact, used a variety of different analyses in those cases cited (App. Ex. 4L). Mr. Farrar has fully described the basis for his growth estimate in this case, and his recommendation must stand or fall on its merits. It should not and will not be dismissed merely because it differs from staff conclusions in other cases.

The Commission must begin the review of Mr. Farrar's growth analysis by correcting applicant's repeated misstatement that the staff witness's estimate of growth is based only on a two-year "b x r" calculation (App. Ex. 4A, p. 7; Tr. XXIV, p. 20; App. Brief, p. 37). This is plainly not the fact. Mr. Farrar's analysis begins with his observation that the result of the "b x r" calculation for the year 1978 showed a precipitous drop from the "b x r" for prior years (Tr. XXIV, pp. 24-25). For the years 1978 and 1979, "b x r" was 1.84 percent and 2.48 percent, respectively, yielding an average "b x r" for this two-year period of 2.16 percent (Staff Ex. 11, p. 22). Mr. Farrar compared this figure to the "b x r" computed for the five-year period, 1975 through 1979, of 3.58 percent and the ten-year period, 1970 through 1979, of 3.77 percent (S.R., p. 29). The magnitude of the disparity prompted Mr. Farrar to explore

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

possible explanations for this break in the historic growth pattern. He noted that earnings per share for 1979 were well below the experience of 1974 (S.R., p. 29). As calculated by Mr. Farrar, the log-linear growth rate of earnings since 1974 was 0.76 percent (S.R., p. 29). For the period since 1975, it was 1.98 percent (S.R., p. 29). This evidence led Mr. Farrar to conclude that there may have been a basic restructuring between the yield and growth components of investor requirements relative to this utility (Staff Ex. 11, p. 9). This interpretation is certainly plausible in light of the decline in applicant's stock prices (Staff Ex. 11, p. 14). Growth expectations appear to have declined, while yield requirements have obviously increased. The use of a five-year average " $b \times r$ " would not be consistent with this explanation of the basis for the drastic change in " $b \times r$ " between 1977 and 1978. Based on the data discussed above, estimates of earnings growth from other sources (Tr. XXIV, p. 21), and historical earnings growth rates, both compound and log-linear (Tr. XXIV, p. 24), Mr. Farrar's opinion was that 2.25 percent represents a reasonable estimate of investor's future growth expectations.

Both of applicant's witnesses attempted to minimize the significance of earnings growth rates in determining the estimated growth in dividends for purposes of the DCF calculation (App. Ex. 8, p. 23; App. Ex. 4A, p. 11). It should be obvious, however, that a policy of continuing to increase dividends in the absence of corresponding increases in earnings can only be maintained for so long. As witness Maugans contends, applicant's dividend growth has been relatively stable for some time; but we have already seen that earnings growth has not kept pace (S.R., p. 29). This should in no way be taken as a criticism of applicant's dividend policy. It does, however, tend to support Mr. Farrar's position with respect to the import of the abrupt change in " $b \times r$ " in 1978. In 1978, applicant's divi-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

dend payment ratio reached an all-time high (S.R., p. 32), and it was in 1978 that applicant's market-to-book ratio, on an annual basis, fell below 1.0 for the first time (S.R., p. 37). The Illuminating Company had historically been the strongest of the Ohio electrics in terms of market-to-book, but despite the fact that it had exhibited the most stable growth in dividends, and despite the fact that it was paying the second highest actual dividend of the other Ohio electrics, it entered 1978 with the poorest market-to-book ratio of the six companies (S.R., p. 33). Thus, as Mr. Farrar's analysis would suggest, it is certainly possible that by 1978 applicant's investors had come to recognize that the practice of increasing the current dividend without concomitant earnings support was nothing more than a borrowing from future dividends (Staff Ex. 11, pp. 16-17). The historical dividend growth rate is certainly relevant in estimating future growth. However, earnings growth, and its relationship to dividends growth, is deserving of far more attention than either of applicant's witnesses devoted to it.

Having considered applicant's complaint that the period analyzed by Mr. Farrar for purpose of estimating the growth component of the DCF formula was too short, the Commission must, itself, question whether the period examined by Mr. Jeffries may not have been too long. It can be stated without fear of contradiction that the conditions faced by the electric utility industry today are vastly different from those which obtained prior to 1974. Indeed, Mr. Maugans expressly recognized this fact in limiting the risk premium analysis he described in his original testimony to the most recent five years (App. Ex. 4, p. 34). Upon cross-examination by staff counsel, he also agreed that in light of the changed circumstances it was unrealistic to expect the company to return to the earnings level of the period 1968 through 1977 (Tr. X, p. 38). Mr. Maugans listed a number of the more significant of these changed

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

conditions: unprecedented, sustained inflation; lower sales growth; increased fuel costs; more governmental and regulatory involvement in all aspects of operation; more consumer activism; increased lead times for the construction of generating facilities and the decrease in quality of earnings resulting from the attendant increase in AFUDC charges; and extremely volatile short and long-term interest rates (App. Ex. 4, pp. 34-35). Although it is readily apparent that these factors increase the risk to the equity investor and, accordingly, create much higher yield requirements, it is hard to understand why they should have any sort of sustaining effect on historical growth expectations.

In light of the foregoing discussion, the Commission is of the opinion that Mr. Farrar's estimate of expected growth is more reasonable than that offered by Mr. Jeffries. The 4.0 percent growth projection fails to adequately consider applicant's recent earnings history and is based on an analysis of a time period which includes years in which conditions were far different from those that may reasonably be anticipated in the future. Even if we were to assume the longer time frame to be appropriate, a mere change in the reference from 1968 through 1978, to 1970 through 1979, would produce a significant change in the earnings growth rate. Using the log-linear method, it drops from the 3.2 percent calculated by Mr. Jeffries to approximately 2.5 percent (Tr. XXIV, p. 24). The compound growth rate for the last ten years is just over 2.0 percent (Tr. XXIV, p. 24). Mr. Farrar's recommendation is internally consistent, for he couples his finding of investors' diminished future growth expectations with a recognition of their increased yield requirements. In fact, his recommended cost of equity is, to our knowledge, the highest ever sponsored by a staff witness and, at its upper bound, is certainly well above any heretofore authorized by the Commission. Further, the reasonableness of his 2.25 per-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

cent growth rate is confirmed by the results of the risk premium analysis he performed which demonstrates that the use of a higher growth rate would have resulted in a risk differential far in excess of the average for the last five years (S.R., pp. 29-30). Applicant's objections relative to this area should be overruled.

The Commission's acceptance of a 2.25 percent growth component for the DCF calculation does not bring our rate of return inquiry to an end, as each of the witnesses significantly revised his original cost of equity recommendation at hearing. Mr. Jeffries summarized the changes in economic conditions which have occurred since the time his original testimony was filed (App. Ex. 8A, pp. 1-4). Among the most significant of these changes was the Federal Reserve Board's pronouncement of October 6, 1979, with respect to the adoption of a restrictive monetary policy designed to slow inflation. Indeed, the Commission has discussed the impact of this action in several recent rate orders. (See, *e.g.*, *Cincinnati Gas and Electric Company*, Case No. 79-11-EL-AIR [January 7, 1980]; *Toledo Edison Company*, Case No. 79-143-EL-AIR [February 29, 1980]). As Mr. Jeffries observes, the prime rate was in the area of 13 percent in September of 1979. At the outset of the hearing in these matters it was in excess of 19 percent (App. Ex. 8A, p. 3). Mr. Maugans, in explaining the sensitivity of utility stock prices to prevailing interest rates, points out that on October 3, 1979, the price per share of applicant's common stock was \$17.625, but by March 5, 1980, it had dropped to \$14.25 (App. Ex. 4A, p. 4). Inflation has continued unabated (App. Ex. 8A, p. 3).

There is no doubt that the cost of equity capital to the company increased significantly during the period between October of 1979 and the time these matters came on for hearing at the beginning of April, 1980. The question is, however, how to appropriately recognize these

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

changes in the cost of capital analysis. It will be recalled that in their original testimony both Mr. Jeffries and Mr. Farrar based their determination of the DCF yield component on the average stock price for a twelve-month period. Both cautioned against the use of spot yields in the calculation. Consistent with that methodology, each of the witnesses updated their yield computations to include more recent market data. Mr. Jeffries used the average price for the twelve months ending with February, 1980 (App. Ex. 8A, p. 4). Mr. Farrar brought his calculation forward through March, 1980, which produced an even higher yield determination; specifically, 11.86 percent (Tr. XXIV, pp. 3-4). This update pushed Mr. Jeffries' original equity return recommendation to the 16.0 to 17.0 percent range (App. Ex. 8A, p. 4). Mr. Farrar's recommendation is now 14.56 to 15.52 percent. Yet despite the fact that Mr. Farrar used precisely the same method as its own witness, applicant now complains that staff's yield determination is unreasonable (App. Ex. 4A, pp. 6-7; App. Brief, p. 38).

Applicant argues that if the return authorized is to reflect current investor requirements, the yield component should be calculated with reference to the average stock price over the last quarter of 1979 and the first quarter of 1980 (App. Ex. 8A, p. 5). As precedent for such a measure, the company cites this Commission's decision in the *Cincinnati Gas and Electric Company* case, *supra*, wherein we did employ a three-month rather than a twelve-month period for determining price based on reasoning similar to that now espoused by the applicant. However, there are factors present here which persuade the Commission that the twelve-month period remains appropriate for purposes of these proceedings.

As indicated above, the period following the Federal Reserve Board's October, 1979, announcement saw a steady rise in the prime rate. In light of additional mone-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

tary and credit actions taken by the Board in March of 1980 (App. Ex. 8A, p. 1), this trend was reinforced. At that time, no one could reasonably anticipate that this situation would reverse itself in the near-term, at least not to the degree that has actually been the case (Tr. X, p. 124). On April 21, 1980, the prime rate was 19¾ percent (Tr. X, p. 121), but by May 13, 1980, it had dropped to 16½ percent (Tr. XXVI, p. 73). Since the conclusion of the hearings in these matters, it has fallen to 12 percent (*Wall Street Journal*, June 13, 1980). As Mr. Maugans testified, the utility stock prices should tend to respond to a drop in interest rates somewhat more quickly than the market as a whole (Tr. X, p. 119). This prediction has proved accurate, as applicant's stock has rebounded from an all-time low to where it is now selling in the \$17 to \$18 per share range.

In light of these developments, Consumers' Counsel argues that the Commission should ignore, as extraordinary, the conditions which prompted the witnesses to revise their cost of equity recommendations (O.C.C. Brief, p. 11). The City of Cleveland advances a similar claim (City of Cleveland Brief, p. 8). Thus, on the one hand, we have the company contending that the data before October of 1979 is irrelevant, while on the other, we are confronted with intervenors' arguments that events since that time should not be considered. All this goes to point up the wisdom of Mr. Farrar's use of a twelve-month period for measuring yield in order to even out short-term fluctuations (Staff Ex. 11, p. 14). Under the circumstances of this case, the Commission believes Mr. Farrar's recommendation to be reasonable, and we accept his determination of the yield component as providing an appropriate basis for the DCF analysis.

Combining Mr. Farrar's yield of 11.86 percent with his estimate of expected growth of 2.25 percent produces a base line cost of equity 14.11 percent. After application

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

of the appropriate adjustment factors (S.R., p. 29), a range of 14.56 to 15.52 percent results. Although these limits have an aura of precision about them, it is clear from the foregoing discussion that the recommended range is no more than the summation of individual judgments. Given this fact, the Commission concludes that 15.0 percent, which falls at the approximate mid-point of this range, represents a reasonable estimate of the cost of equity capital to this utility.

**Attrition Adjustment:**

Applicant proposes an adjustment of some \$13.8 million to account for inflation and to offset earnings erosion subsequent to the test period (App. Ex. 1, Sched. C-3.20, p. 103). The staff opposes the adjustment (S.R., pp. 17-18). Although presented as an expense adjustment, the Commission believes it appropriate to consider this item in connection with our rate of return discussion.

The Commission has had occasion to consider the question of an allowance for attrition in a number of its recent rate decisions. The specific proposals have taken a variety of forms ranging from an augmentation of the rate of return as presented by this company in its last rate case (*Cleveland Electric Illuminating Company*, Case No. 78-677-EL-AIR [May 2, 1979]), to adjustments to cost of service to reflect projected future expenses (See, e.g., *Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979]). The Commission has generally rejected adjustments of this type, finding them to be inconsistent with the test-year concept of rate regulation (*Columbia Gas of Ohio, Inc. [Columbus]*, Case No. 76-704-GA-AIR [June 29, 1977], aff'd *sub nom Franklin County Welfare Rights Organization v. Public Utilities Commission*, 55 Ohio St. 2d 1 [1978]). Although recognizing that regulated utilities are among the primary victims of inflation due to their inability to readily adjust prices, the Com-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

mission has pointed out that reduced regulatory lag and appropriate expense annualizations have served to lessen its impact. More important, perhaps, from the standpoint of regulatory theory, is the fact that investors capitalize the risks of inflation in making their investment decisions. Thus, this element is reflected in the market price of the stock which, in turn, is built into the DCF analysis of the cost of equity upon which the authorized rate of return is based. The Supreme Court has recognized these considerations in upholding Commission decisions denying attrition allowances (*Franklin County Welfare Rights Organization v. Public Utilities Commission, supra*; *Masury Water Company v. Public Utilities Commission*, 58 Ohio St. 2d 1 [1979]).

Applicant correctly points out that the Commission has, in one prior instance, adjusted the allowed rate of return to recognize the impact of attrition on the resulting revenues (*Columbus and Southern Ohio Electric Company*, Case No. 78-1438-EL-AIR [December 29, 1979]). However, as the Commission was careful to explain in the order cited by applicant, that case involved a company facing a unique combination of circumstances which threatened its basic financial integrity. We do not believe that all those same factors have coalesced in this case. The Commission, therefore, rejects applicant's proposed attrition allowance for those reasons repeatedly stated in prior orders wherein we have considered this subject.

**Rate of Return Summary:**

Applying a cost of equity of 15.0 percent to the equity component of the capital structure approved herein produces, when combined with the findings relative to long-term debt and preferred stock, a weighted cost of capital of 10.82 percent. The Commission is of the opinion that a rate of return of 10.82 is sufficient to provide the company reasonable compensation for the electric service it renders customers affected by these proceedings.

**AUTHORIZED INCREASE**

A rate of return of 10.82 percent applied to the jurisdictional rate base of \$1,485,734,000 approved for purposes of these proceedings results in an allowable return of \$160,756,000. Certain expenses must be adjusted if the gross revenues authorized are to produce this dollar return. These adjustments, which have been calculated in a manner consistent with the findings herein, result in an increase in the allowance for federal income tax of \$30,705,000, in the allowance for other taxes of \$2,748,000, and in the provision for uncollectibles of \$143,000. The net effect of these adjustments is to increase allowable expenses to \$682,274,000. Adding the approved dollar return to the allowable expenses results in a finding that applicant is entitled to place rates in effect which will generate \$843,030,000 in gross annual operating revenue. This represents an increase of \$69,641,000 over the revenues which would be realized under applicant's present rate schedules. Similar calculations for the application area and the City of Cleveland would indicate that increases in gross annual revenues of \$47,446,000 and \$22,195,000 would be required if the applicant is to realize the dollar return resulting from the application of the authorized rate of return to the respective rate bases. Although our analysis suggests that the existing revenue deficiency is slightly greater in the City of Cleveland than in the application area, applicant has proposed a uniform increase in both rate areas. The Commission is of the opinion that the rates of return on the respective rate bases which result from maintaining uniform rates fall within acceptable limits around the jurisdictional rate of return and that rates may properly be established on a total jurisdiction basis.

Through filed objections to the staff report, several parties have taken exceptions to the staff's failure to address the question of whether the increase proposed by the company complies with guidelines promulgated by the Council

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

on Wage and Price Stability. The Commission has noted on a number of previous occasions that this agency is charged by statute to decide rate applications in accordance with state law and that the voluntary guidelines cannot limit the level of relief authorized (See, e.g., *Dayton Power and Light Company*, Case No. 78-92-EL-AIR [March 9, 1979]; *Dayton Power and Light Company*, Case No. 79-372-GA-AIR [May 7, 1980]). By its filing in these dockets of March 28, 1980, applicant presented an assessment of its compliance with the guidelines in which it indicates that even a grant of the full relief requested would not exceed the limitations. No other party presented evidence on the subject. The foregoing satisfies the Commission's reporting function.

The Commission is well aware of the fact that this company received rate relief a little over a year ago and that even as hearings were beginning in this case it filed notice of its intention to seek yet another rate increase. Inflation, of course, is the principal cause of applicant's ongoing financial dilemma, particularly with respect to its impact on costs associated with the company's construction program. Neither the company nor the Commission can control inflation, but, as discussed previously, there is reason to hope that the announced cancellation of four generating units will have some positive effects on applicant's financial outlook. There is, however, another area where even a modest improvement could have a significant impact with respect to the company's battle against earnings erosion.

The results of actual operations may be significantly influenced when some of a company's largest generating units exhibit poor equivalent availability. These are the very units which when operating at more reasonable capacity levels, produce the least expensive energy. Davis-Besse is obviously applicant's chief offender, a circumstance the Commission has recognized through the normal-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

izing adjustment approved in the cost of service analysis in this case. However, there may be cost-effective improvements which could be pursued with respect to other of applicant's units as well. In its orders in *Columbus and Southern Ohio Electric Company*, Case No. 78-1438-EL-AIR (December 12, 1979) and *Cincinnati Gas and Electric Company*, Case No. 79-11-EL-AIR (January 7, 1980), the Commission described a staff program, undertaken in connection with the Department of Energy, to investigate the costs and benefits associated with improved power plant productivity. Staff witness Hunt offered testimony in these proceedings commending applicant for the steps taken to date to improve unit availability and urging that these efforts be continued (Staff Ex. 9, pp. 9-10). The staff recommends that the company be required to submit quarterly reports on the immediate past performance of its generating units, in a form to be agreed upon by the applicant and the staff, to be used in establishing a statewide power plant productivity data base to assist in monitoring power plant performance (Staff Ex. 9, pp. 10-11). In recognition of the importance the Commission attaches to this subject, we will so order.

**TARIFFS**

The recommendations offered by the staff after its review of applicant's proposed tariffs drew relatively few objections (S.R., pp. 52-61). Those staff recommendations not subject to specific objection or modification should be implemented. There are, however, several remaining tariff questions which the Commission must consider.

**Customer Charge:**

In applicant's last rate case, the Commission adopted a staff recommendation which introduced a customer charge component into applicant's residential and small commer-

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

cial rate schedules for the first time. This measure was consistent with all other recent electric rate orders. The purpose of the flat charge is to recognize that there are costs incurred by the company merely by virtue of the fact that a customer is on the system, without regard to usage considerations. Applicant's proposed residential tariffs include a customer charge of \$3.00, a slight reduction from the \$3.05 charge approved in the prior case. The staff considers the charge to be acceptable in light of the customer charges currently in effect for other utilities in the state (Staff Ex. 10, p. 3). Applicant's witness Bingham, who sponsored applicant's proposed tariffs, agreed with staff witness Groves that the concept of a customer charge was theoretically correct (App. Ex. 7A, p. 5). However, he noted that there had been poor customer acceptance of the charge as evidenced by the many complaints received by the company with respect thereto (App. Ex. 7A, p. 5). Customer acceptance is, of course, an important consideration in rate design, but it must be balanced against the also important principle that rates should reflect cost. Given the modest nature of the customer charge proposed and the fact that it actually represents a decrease from that currently in effect, the Commission believes this feature should be retained. It is hoped that customer opposition will diminish as experience is gained with the charge.

**Energy Conservation Rate:**

Applicant's proposed residential tariff continues the energy conservation schedule approved by the Commission in the company's prior rate case. This schedule is available to customers whose dwelling units meet certain insulation and other energy conservation standards. Intervenor City of Cleveland challenged this rate on the basis that it is not cost-justified, a fact which is somewhat ironic in that the Cleveland ordinance from which the complaint and appeal is taken also contains this rate provision. Based on

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

his analysis of a single study, City of Cleveland witness Rothery concluded that the rate was not cost-based (City of Cleveland Ex. 9, pp. 15-17). Cross-examination indicated that there was other relevant data which might have been considered (Tr. XXV, pp. 50-55), and the witness agreed that there were other considerations to be taken into account in rate designs in addition to cost of service principles (Tr. XXV, p. 49). No further discussion is required as the Supreme Court in *City of Cleveland v. Public Utilities Commission*, S. Ct. Case No. 79-1158 (July 9, 1978), 63 Ohio St. 2d (1980) reviewed this same schedule and determined that it furthered a proper objective. Intervenor's objection is overruled.

**Space Heating and Water Heating Schedules:**

Applicant's tariffs offer a separate rate for space heating and water heating customers whose appliances were installed prior to Commission orders closing the rate in *Cleveland Electric Illuminating Company, Case No. 71-634-Y* (November 28, 1979), Order on Remand (July 3, 1975). In reviewing the history of these provisions, the staff found that the original order closing the rate indicated that "customers" were to be grandfathered, while the language of applicant's tariffs limits the rate to "installations." The staff recommended that this language be amended to conform to the aforementioned orders. Applicant acknowledges that the orders in question do refer to "customers", but points out that the tariffs have always contained the "installation" phraseology. As these tariffs have been accepted for filing by a succession of Commission entries, Applicant argues that the Commission has approved the concept. We need not discuss the implications of these prior entries, for, no matter what they may have said, we now find that the availability of rate should be limited to existing customers. The idea advanced by applicant that some sort of property right attaches to the availability of this

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

rate is absurd (Tr. XVIII, pp. 28-29). There is no transferable property right in any utility rate. Although grandfathering may, on occasion, be appropriate for existing customers to give effect to equitable considerations, the very idea in closing a rate is that it will eventually disappear through attrition. How will this process proceed at any meaningful pace if the limiting provisions apply to installations rather than customers? Applicant's objection to the staff recommendation is overruled.

**General Commercial Schedule:**

Two questions exist with respect to the company's proposed general service schedule. Applicant proposed to reinstitute a two-part declining block rate in the summer rates contained in this schedule. The staff, although originally recommending rejection of the change, has now dropped its opposition. Applicant's witness Bingham amply supported the return to the two-block rate through his supplemental testimony (App. Ex. 7A, p. 4). This rate design is hereby approved for this schedule.

The second issue which has arisen with respect to this schedule is whether the return being earned from this service is inadequate when compared to the return on other services. Based on the cost of service study submitted in this case (App. Ex. 9, p. 1), applicant concluded that this was, in fact, the case. The staff concurs in this judgment (S.R., pp. 57-58). The Commission, therefore, directs that the proposed distribution of revenue requirements embodied in the rate schedules as originally filed be adjusted so that revenues under the general service schedule more nearly approximate the average return under the other schedules. In accordance with the recommendation of Mr. Bingham, the extent to which this change results in a lower revenue requirements from other customer classes should be recognized through a pro

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

rata reduction based on existing revenue levels (Tr. XVIII, pp. 27-28).

**Effective Date:**

The general practice of this Commission has been to fix the effective date of tariffs filed pursuant to its rate orders as thirty days following the issuance of the entry accepting the tariffs for filing. The purpose of this delay is to afford affected customers notice of the increase authorized through mailings by the company prior to the date the new rates become applicable. The Commission continues to believe this to be a reasonable practice, but finds circumstances present in this case which compel a departure from this policy.

Section 4909.42 Revised Code provides that if the Commission has not acted upon a rate increase application within 275 days of the date of filing, the applicant utility, upon the filing of an undertaking, may place its proposed rates into effect subject to the condition that amounts collected under rates charged which are in excess of those ultimately determined reasonable by the Commission must be refunded. The Commission makes every effort to issue its rate orders in advance of the expiration of 275-day time period in order to avoid the customer confusion which might result should the refund provision be invoked. Due to the extraordinary length of the hearings in these dockets, this was not possible in this instance. However, applicant has made no attempt to place its proposed rates in effect and the Commission believes that basic principles of fairness dictate that the company not be penalized for its forbearance. The Commission, therefore, finds the appropriate course in these proceedings to be to establish the effective date of the tariffs filed pursuant to this order as the date they are approved by Commission entry. The customer notification requirement will,

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

of course, be retained; said notice to be mailed to affected customers upon approval of its form by the Commission.

**FINDINGS OF FACT:**

From the evidence of record in these proceedings, the Commission now makes the following findings:

- 1) The value of all of applicant's property used and useful for the rendition of electric service to the customers affected by this application and complaint and appeal determined in accordance with Section 4909.05 and Section 4909.15 Revised Code as of the date certain of June 30, 1979, is not less than \$1,485,734,000.
- 2) The value of the rate base properly allocable to the application area is not less than \$1,030,866,000.
- 3) The value of the rate base properly allocable to the City of Cleveland is not less than \$454,868,000.
- 4) For the twelve month period ending December 31, 1979, the test period in these proceedings, the revenues, expenses, and income available for fixed charges realized by applicant under its present permanent rate schedules were \$773,389,000, \$648,678,000, and \$124,711,000, respectively.
- 5) The revenues, expenses, and income available for fixed charges realized by applicant in the application area were \$542,489,000, \$455,507,000, and \$86,982,000, respectively.
- 6) The revenues, expenses, and income available for fixed charges realized by applicant the City of Cleveland under present rates now continued in effect by the ordinance complained of were \$230,900,000, \$193,171,000, and \$37,729,000, respectively.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

- 7) The total net annual compensation of \$124,711,000 represents a rate of return of 8.39 percent on the jurisdictional rate base.
- 8) The net annual compensation of \$86,982,000 realized by applicant in the application area represents a rate of return of 8.44 percent on the allocated rate base.
- 9) The net annual compensation of \$37,729,000 realized by applicant in the City of Cleveland represents a rate of return of 8.29 percent on the allocated rate base.
- 10) Rates of return of 8.39 percent, 8.44 percent, and 8.29 percent are insufficient to provide applicant reasonable compensation for the electric service rendered customers affected by the application and complaint and appeal.
- 11) A rate of return of 10.82 percent is fair and reasonable under the circumstances presented by these cases and is sufficient to provide applicant just compensation and return on the value of its property used and useful in furnishing the service described in the application and complaint and appeal.
- 12) A rate of return of 10.82 percent applied to the the jurisdictional rate base of \$1,485,734,000 will result in income available for fixed charges in the amount of \$160,756,000.
- 13) The allowable annual expenses of applicant for purposes of these proceedings are \$682,274,000.
- 14) The allowable gross annual revenue to which applicant is entitled for purposes of these proceedings is the sum of the amounts set forth in Findings 12 and 13, or \$843,030,000.
- 15) Applicant's present tariffs should be withdrawn and cancelled and applicant should submit new tariffs consistent in all respects with the discussion and findings set forth above.

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

- 16) The tariffs submitted by applicant shall contain base (or non-fuel) rates and charges sufficient to yield gross revenues which will compensate the company for allowable test period operating expenses, exclusive of fuel costs includable in its fuel adjustment clause, and yield a 10.82 percent rate of return on its rate base of \$1,485,734,000.
- 17) The provisions of these tariffs should be substituted for the provisions of Ordinance No. 1673-79 of the City of Cleveland.
- 18) Applicant shall be required to submit quarterly reports, in a form to be agreed upon by the company and the staff, detailing the immediate past performance of its generating units.

**CONCLUSIONS OF LAW:**

- 1) The application herein is filed pursuant to, and this Commission has jurisdiction thereof, under the provisions of Sections 4909.17, 4909.18 and 4909.19 Revised Code; further, applicant has complied with the requirements of the aforesaid statutes.
- 2) The instant complaint and appeal is filed pursuant to, and this Commission has jurisdiction thereof, under the provisions of Section 4909.34 Revised Code; further, applicant has complied with all applicable statutory requirements.
- 3) A staff investigation has been conducted and a report duly filed and mailed and public hearings have been held herein, the written notice thereof having complied with the requirements of Section 4909.19 Revised Code.
- 4) The existing rates and charges now being charged and collected by applicant for electric service to customers affected by this application are insufficient to provide the company with adequate net annual compensation and return

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

on its property used and useful in the rendition of electric service.

- 5) The rates for electric service contained in Ordinance No. 1673-79 of the City of Cleveland are insufficient to provide applicant adequate net annual compensation and return on its property used and useful in furnishing the service governed by said ordinance.
- 6) A rate of return of 10.82 percent is fair and reasonable under the circumstances of these cases and is sufficient to provide applicant just compensation and return on its property used and useful in the rendition of electric service to its customers.
- 7) Applicant should be authorized to cancel and withdraw its presently effective tariffs on file with this Commission and to file new tariffs consistent in all respects with the discussion and findings set forth above.
- 8) The provisions of these tariffs should be substituted for the provisions of Ordinance No. 1673-79 of the City of Cleveland.

**ORDER:**

It is, therefore,

**ORDERED,** That the application of Cleveland Electric Illuminating Company for authority to increase its rates and charges for electric service be, and hereby is granted to the extent provided in this Opinion and Order. It is, further,

**ORDERED,** That the complaint and appeal of Cleveland Electric Illuminating Company from Ordinance No. 1673-79 of the City of Cleveland be, and hereby is sustained and that relief be, and hereby is authorized to the extent provided in this Opinion and Order. It is, further,

**Opinion and Order, PUCO Case No. 79-537-EL-AIR**

ORDERED, That applicant be, and hereby is authorized to cancel and withdraw its present permanent tariffs and to file new tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) complete copies of tariffs conforming to this Opinion and Order, the Commission will review and approve same by entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date said tariffs are accepted for filing. The new rates contained therein shall be applicable to all service rendered on or after the effective date. It is, further,

ORDERED, That applicant shall immediately commence notification of its customers of the increase in rates authorized herein by insert or attachment to its billings, by special mailing, or by a combination of these methods. Applicant shall submit a proposed form of notice to the Commission when it files its tariffs for approval and the Commission will review same and, if proper, approve it by entry. It is, further,

ORDERED, That applicant submit quarterly reports in a form to be agreed upon the company and the staff detailing the immediate past performance of its generating units. It is, further, -

ORDERED, That all objections and motions not specifically discussed within this Opinion and Order or rendered moot thereby be, and hereby are overruled and denied. It is, further,

ORDERED, That copies of this Opinion and Order be served upon all parties of record.

Opinion and Order, PUCO Case No. 79-537-EL-AIR

THE PUBLIC UTILITIES  
COMMISSION OF OHIO

/s/ WILLIAM S. NEWCOMB, JR.  
(Chairman)

MICHAEL DELBANE  
Voted no.

/s/ STEPHEN A. REILLY

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(Commissioners)

Entered in the Journal

July 10, 1980

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A True Copy

DAVID M. POLK

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David M. Polk  
Secretary

Order on Motion, FERC Doc. No. ER81-612-000

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

The Cleveland Electric  
Illuminating Company

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Docket No.  
ER81-612-000

ORDER ON MOTIONS FOR  
SUMMARY DISPOSITION

(April 14, 1982)

There is at issue in this proceeding the lawfulness of a proposal by Cleveland Electric Illuminating Company (CEI) to increase rates and charges for firm partial requirements service to the City of Cleveland (City) which will increase revenues from such sales by \$2,237,492 annually for YE December 31, 1981. The Commission accepted the rate schedules for filing, suspended the rates for one day to take effect on September 15, 1981, subject to refund, and set the matter down for a public hearing.

The Commission ordered the deferral of a possible price squeeze issue until after a final decision is entered on the cost of service, capitalization and rate of return issues in this phase of the case.

Staff has filed four motions for summary disposition of certain issues in this case which it claims can be disposed of without litigation because there are only questions of law and policy involved of such a nature that there is neither a dispute as to material facts, nor a need to ventilate the underlying facts to aid in policy determinations. *Municipal Light Boards v. F.P.C.* 450 F.2d 1341 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 989 (1972). Rulings on the Staff motions will not be a final determination of all issues in this case. Hence, the motions will be dealt with in accordance with the provisions of sections 1.12(d)

**Order on Motion, FERC Doc. No. ER81-612-000**

and 1.27(b)(7) of the Commission's Rules of Practice and Procedure. *Minnesota Power and Light Company*, Docket No. ER78-425, order issued on March 26, 1979.

The motions involve CEI's ratable flow-through of investment tax credits (ITC) to cost of service and the reduction of rate base by accumulated deferred investment tax credits (ADITC), the methodology used to calculate interest expense for federal income tax purposes, the cost of service treatment for amortized losses related to abandoned nuclear generating units, and the limitation of the issues in this phase to the justification of the minimum billing demand provision of Service Schedule B.

**I**

Staff states that CEI's rate filing establishes that the company ratably flowed through ITC to cost of service and deducted ADITC balances in Account 255 from rate base. It is Staff's position that it is inconsistent with Commission precedent and contrary to the provisions of section 46(f)(2) of the Internal Revenue Code (IRC) for a regulated utility to ratably flow-through ITC to income and also to reduce rate base by the ADITC balances.

The City filed an answer in opposition to Staff's motion. City contends, in substance, that regulated utilities have an option to choose between the full utilization treatment of ITC under section 46(f)(1) of the IRC, or the ratable flow-through method under section 46(f)(2), and that, contrary to Staff's interpretation, Congress intended to impose restraints on regulatory agencies, not regulated utilities, with respect to the rate of flow-through and rate base adjustments. Thus, City argues, if the Commission ordered CEI to deduct ADITC from rate base, the company would lose the ITC, but CEI adjusted the rate base voluntarily, so Staff's premise that the reduction

**Order on Motion, FERC Doc. No. ER81-612-000**

in rate base in this instance is contrary to section 46(f)(2)(B) is in error.

CEI supports Staff's position that the reduction in rate base by ADITC balances coupled with the ratable flow-through of ITC does not comport with the provisions of section 46(f) and Commission policy. It also refutes City's position that there is a distinction between a reduction in rate base ordered by the Commission and a cost of service study submitted by a utility as support for a proposed rate change.

Clearly, there are no material facts in dispute insofar as the investment tax credit issue is concerned.

CEI acknowledges that it reduced the rate base by ADITC balances in Account 255, and that this adjustment could cause the loss of ITC, which would be detrimental to both the company and the ratepayers.

City does not question Staff's factual allegations. It merely argues points of law and agency policy.

The second option in section 46(f) provides that the ITC is not available to a company if the credit to income is flowed-through faster than ratably over the useful life of the property that produced the tax benefits, but there must not be any adjustment to the rate base. In other words, tax savings cannot be flowed-through to reduce cost of service by more than a ratable portion of the tax credit, and ADITC balances cannot be deducted from the rate base. *Carolina Power and Light Co.*, Opinion No. 19 (August 2, 1978). It is clear that the statute intends the benefits of the tax credits to be shared by the ratepayers and the investors. The limited flow-through will produce lower cost of service over the useful life of the plant for the benefit of consumers, and investors will earn a return on a portion of the rate base to which they did not contribute. *Union Electric Company*, Opinion No. 94-12 FERC ¶ 61,239 (1980); *Public Service Company of New Mexico v. FERC*, 653 F.2d 681 (D.C. Cir. 1981).

The legislative history cited by City controverts the argument that Congress intended to limit the restraints imposed on the options available under section 46(f) of the IRC to regulatory agencies. The conference committee report states that if the regulatory agency ignores the limits on the rate of flow-through, or insists upon a greater rate base adjustment than is permissible under the applicable option, the company will not be allowed to take any investment credit. H.R. Rep. No. 92-533, 92d Cong., 1st Sess. (1971). Section 46(f)(2) refers only to actions taken by the taxpayer. There is no implicit or explicit language to support the notion that a taxpayer can elect to ratably flow-through investment credits to cost of service and then *voluntarily* reduce or adjust the rate base and still remain eligible for ITC in the applicable taxable periods. Such a conclusion would frustrate the intent and purpose of section 46(f)(2) to assure a limited flow-through of tax savings to ratepayers and cost-free capital for the utility upon which investors will earn a return. *Union Electric Company v. FERC*, 668 F.2d 389 (8th Cir. 1981).

The motion for summary disposition is granted.

CEI is directed to remove ADITC balances from rate base, and to adjust the cost of service study in this proceeding accordingly for ratemaking purposes.

## II

Staff contends that the rate filing shows that CEI's interest expense deduction for federal income taxes was computed by using the interest expense as shown on the income statement for YE December 31, 1981, offset by an allowance for borrowed funds used during construction and an allocation of interest expense to nonoperating income. Staff contends that Commission precedent requires

**Order on Motion, FERC Doc. No. ER81-612-000**

CEI to calculate the interest expense deduction by multiplying the weighted cost of debt used in developing the overall rate of return by the rate base.

CEI filed an answer in opposition to Staff's motion.

First, CEI claims that both the Staff and company cost of service studies show that CEI is entitled to a revenue increase of approximately \$2.8 million, which is significantly in excess of the claimed \$2.2 million revenue increase. CEI asserts that the controlling issue is not whether there is comparability in the computational techniques used, but whether the rates proposed meet the statutory standards of justness and reasonableness; it is not the theory but the impact that counts. *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

CEI contends that the cost of service studies to be offered by the company, City and Staff were prepared by experts, each qualified to make judgments regarding the techniques best suited to determine the allocated cost to CEI of providing wholesale electric service to City. Any disagreements among the experts should be resolved only after the parties have had an opportunity to subject testimony and exhibits to the disciplines of cross-examination.

Finally, CEI states that the cases cited by Staff as support for the method it used to calculate the interest expense deduction for federal tax purposes do not establish a policy to be followed in all cases. Rather, the findings in each of the cases were based on facts of record therein and do not justify the adoption of the Staff methodology in this proceeding.

CEI is correct, the cases relied upon by Staff to support the motion on interest synchronization are distinguishable on the facts and the law. In one case, the Commission approved Staff's technique to calculate the interest expense deduction holding that the same cost basis used to compute the return allowance should be used to develop the in-

**Order on Motion, FERC Doc. No. ER81-612-000**

terest expense. *Alabama Power Company*, Opinion No. 54 (August 1, 1979). Another case involved the computation of the interest expense deduction using a capital structure that did not include ADITC and a rate base that was reduced by ADITC balances the effect of which increased tax allowance and cost of service to the detriment of the ratepayers. *New England Power Company*, Docket Nos. ER80-66, ER80-67, and ER80-68, order issued on December 31, 1979. At issue in a third case cited by Staff was whether the data used by Staff to compute interest expense deduction for tax purposes had been properly matched and synchronized. The Commission ruled that Staff had relied on data reflecting neither the appropriate rate base nor the appropriate debt cost. In this case, the Commission found that the formula previously endorsed in Opinion No. 54 usually produced a more acceptable result. *Public Service Company of New Mexico*, Opinion No. 133, 17 FERC ¶ 61,123 (1981).

None of these cases can be considered as a controlling precedent or a policy declaration on the methodology to be used to synchronize interest expense for federal income tax purposes. Even though there is a line of Commission opinions that favors Staff's computational technique, it is not sufficient to reject a different computational technique especially where, as here, the cost of service results are comparable and the revenue requirements are shown to be cost justified. Ratemaking agencies are not bound to any single formula or combination of formulas. The quasi-legislative ratemaking powers of regulatory agencies confer the authority to make pragmatic adjustments which may be called for by particular circumstances. *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942). Under the statutory standards of just and reasonable it is the result reached, not the method employed that is controlling. The fact that the method employed to reach a proper result

**Order on Motion, FERC Doc. No. ER81-612-000**

may contain infirmities is unimportant. *F.P.C. v. Hope Natural Gas Co.*, *supra*.

There are no material facts in dispute on the interest expense deduction issue that require a full hearing to assure a full and true disclosure of all the facts. *U.S. v. Storer Broadcasting Company*, 351 U.S. 192 (1956). The parties share different views on the technique to be used to compute the interest expense deduction. Staff synchronized interest expense using a formula which has been adopted by the Commission from time to time, and argues that CEI must do likewise. CEI does not challenge Staff on the facts, it simply contends that the use of booked interest for Period II cost of service was not improper, and that it has a right to present evidence and to cross-examine witnesses on this issue. Ordinarily, a party to an adjudicatory proceeding has a right to present its case and to cross-examine opposing witnesses. But, as CEI implies in its answer to Staff's motion, the interest synchronization issue is moot essentially because both Staff's and the company's cost of service studies show that the proposed revenue increase meets the statutory standards of just and reasonable. This result will still obtain even if CEI used Staff's technique to compute the interest expense deduction.

Where only questions of law and policy are in issue, it would serve no purpose whatsoever to require expert witnesses to explain computational techniques that need no explanation and which, in the circumstances at hand, will have no substantive effect on the cost of service results or the lawfulness of the proposed rate increase. Because the parties used different methodologies to compute the interest expense deduction and thereby reached different results does not mean that a full evidentiary hearing is necessary just to resolve those differences. *New Orleans Public Service, Inc. v. FERC*, 659 F.2d 509 (5th Cir.

**Order on Motion, FERC Doc. No. ER81-612-000**

1981). Indeed, the differences between the parties reflect disagreement on matters of policy rather than a conflict in basic facts. Even though there will be no need for oral testimony, each party will have an opportunity to place in the record all relevant prepared testimony and exhibits on the issue, and to argue points of law on brief, if they so desire, so no party will be deprived of procedural due process. *Ibid.*

It is found and concluded that there are no material facts in dispute to be litigated in a full evidentiary hearing; and it is also found and concluded that none of the cases cited by Staff can be considered as a declaration of policy or a controlling precedent on the methodology to be used to calculate the interest expense deduction. Accordingly, the motion for summary disposition will be denied.

### III

Staff points out that CEI included in cost of service amortized expenses for the write-off of losses connected with the closedown of four nuclear generating units. This is acknowledged by the company and City. Staff states that abandonment losses are properly reflected in cost of service unless such expenses were imprudently incurred, but a positive showing of prudence is not required unless there is evidence or allegations of imprudence, and the precedents support a presumption of prudent management.

Staff takes the position that when there is no showing or allegations of managerial imprudence, there are no material facts in dispute. Therefore, the issue can be resolved by "application of appropriate legal standards."

CEI filed an answer in support of Staff's motion, and an answer in opposition to the motion was filed by City.

CEI represents that the amortized losses charged to

**Order on Motion, FERC Doc. No. ER81-612-000**

cost of service are a portion of the company's investment in nuclear-fueled generating stations where construction was terminated in the design stages and that the charge to cost of service conforms with accounting procedures endorsed by the Public Utilities Commission of Ohio and the FERC. CEI states that it is not aware of any case where the inclusion of these losses in cost of service was disallowed for wholesale rate purposes just because such losses had been rejected for retail rate purposes.

At the outset City argues that the Commission does not have a definitive policy governing cost of service treatment for abandonment losses, and the cases cited by Staff for the proposition that no hearing on this issue is required in this case involved rulemaking proceedings wherein all interested parties had an opportunity to submit briefs or comments before any regulations were adopted.

It is alleged that the Commission has dealt with the abandonment losses issue on a case-by-case basis relying on the facts presented in each case because they "may vary from case to case, requiring different decisions." Such decisions are precedents, but only if on point. According to City, the prepared testimony of a CEI witness, to be offered in evidence at the hearing, that the decision to build the nuclear generating units and the decision to terminate the units were prudent and reasonable is a bare conclusionary opinion with no supporting facts.

It is City's position that the company must not only show that the decisions to build and to terminate the units were prudent, but that the allocation of costs, to the wholesale customers in this case, was proper. *Office of Consumers' Counsel v. P.U.C.*, 423 N.E.2d 820 (Ohio 1981). CEI, not City, has the burden of proof and City has the option to rely on the company's failure to sustain the

**Order on Motion, FERC Doc. No. ER81-612-000**

burden of proof and to rely on evidence "adduced through cross-examination."

Staff has filed a motion for leave to file a response to City's answer. The purpose of the response is to comment on a Commission order relevant to the standards for summary disposition in administrative proceedings, to clarify the intended scope of the motion for summary disposition, and to rebut City's answer with respect to legal precedent and Commission policy on substantive issues. City has filed an answer to Staff's motion to file a response to City's answer to Staff's motion for summary disposition. City's answer is conditional; if Staff's motion to file the response is granted, City requests that the answer also be accepted.

The Commission's Rules of Practice and Procedure do not provide for successive pleadings. As a general rule of procedure, pleadings are not extended beyond a plea in bar except in extraordinary circumstances. Staff's motion and City's answer clearly presented facts and points of law on which the parties disagree. Hence, the issue is joined and no further explication of facts or points of law is needed to rule on the pleadings. Moreover, there are no extraordinary circumstances to consider, or good cause to be served by replications, rejoinders, surrejoinders, rebutters or surrebutters, *ad nauseam*.

Staff's motion to respond to City's answer, and City's answer to the Staff motion are dismissed.

The facts on the plant abandonment loss issue are not in dispute. CEI has included one-tenth of a \$56 million loss in the test year cost of service of which approximately 1.6%, or \$87,453, is jurisdictional. CEI will offer the prepared testimony of two witnesses in evidence. This testimony explains in great detail all of the circumstances relevant to the company's decision to invest in the four nuclear generating plants, the anticipated customer benefits and the reasons for decommissioning the units. By

**Order on Motion, FERC Doc. No. ER81-612-000**

contrast, City has no prepared testimony or exhibits that deal meaningfully with CEI's involvement in the nuclear plant enterprise. There is only a statement in the prepared testimony of one witness to the effect that charging City for a portion of the losses incurred was improper and the Supreme Court of the State of Ohio has so ruled.

There is no declaration of policy on the cost of service treatment for amortization of plant termination losses. But there are precedents on the subject which are instructive and persuasive.

The Ohio Supreme Court decision is not such a precedent. This is the case cited by City for the proposition that it is error for a utility to recover abandonment losses from either retail or wholesale ratepayers. First of all, neither FERC nor any other federal quasi-judicial agency is bound by decisions of state courts under the principles of *stare decisis*. More importantly, the Ohio case is distinguishable on the facts and law.

The court reversed the Ohio Public Utilities Commission's decision to authorize CEI to amortize losses on the four terminated nuclear generating stations in the test period cost of service. The issue before the court was whether the test of prudence was consistent with a statutory ratemaking formula contained in the Ohio Revised Code. The court held that the PUC exceeded its statutory authority when it allowed CEI to amortize the investment in the cancelled plants, that the applicable statute was designed to take into account normal, recurring expenses for providing service to the public in the test period, that the cancellation losses are extraordinary and cannot be declared ordinary operating expenses by PUC fiat, that the statute only allows the PUC to smooth anomalies in the ratemaking equation when the criteria upon which the rate is based are skewed for one reason or another. *Office of Consumers' Counsel v. P.U.C., supra.*

**Order on Motion, FERC Doc. No. ER81-612-000**

There are no provisions in the Federal Power Act, or the Commission's regulations, that require the use of a particular formula to determine whether abandonment losses should be allowed or disallowed in cost of service. Over the past several years the Commission has dealt with abandonment losses a number of times for a variety of reasons. With but one exception, it appears that the utilities have been authorized to write-off cancelled plant losses as a cost of service component. The exception was in a case where the company failed to satisfactorily rebut a presumption of imprudence. *Southern California Edison Company*, Opinion No. 62 (August 22, 1979).

In *New England Power Company*, Docket No. ER76-304, there was no evidence adduced to show that the company's decision to construct an oil-fired electric generating facility was imprudent, or to controvert the reasonableness of the costs involved; and only one party questioned the proposed five-year amortization period to recover abandonment losses from the ratepayers. That party opted for a ten-year period. New England Power was authorized to amortize the losses over a five-year period to cost of service of 30 resale distribution customers and several industrial customers. The cost impact on the ratepayers of 0.5% was not considered burdensome by the Commission. *New England Power Company*, Opinion No. 49 (July 19, 1979).

The Court of Appeals for the District of Columbia Circuit, held that the Commission acted properly when it excluded project expenditures from New England's rate base but at the same time allowed the company to recover losses from ratepayers over a reasonable period. The court concluded that it would be inequitable to place on the utility the entire loss of expenditures which were prudent when made. The Commission's decision struck an equitable balance between the interests of investors and rate-

**Order on Motion, FERC Doc. No. ER81-612-000**

payers by denying a return on unamortized losses and charging consumers a fair share of losses incurred on a project designed to meet anticipated load demands by the public. *NEPCO Municipal Rate Committee, et al. v. FERC*, No. 80-1343, slip op. (D.C. Cir. October 15, 1981).

When a utility is on notice that a party intends to question or challenge abandonment losses, the burden of proof to show prudent management action is on the company. The company is expected to produce substantial evidence to demonstrate convincingly that the action taken at every stage of the plant project was prudent. Vague generalizations about the problems and difficulties inherent in all building projects will not be considered as satisfying the burden of proof obligation. *Southern California Edison Company*, Opinion No. 62 (August 22, 1979). This is not to say that a party may simply make a bare assertion that management acted imprudently and thereby place the whole burden of proof on the company to justify the write-off.

The Commission has held that a utility seeking a rate increase is not required to demonstrate in its case-in-chief that all expenditures were prudent unless filing requirements, policy or precedent so require. Where a party creates a serious doubt as to the prudence of an expenditure, the rate proponent has the burden to dispel all doubts and to prove the costs were the consequence of prudent management. Equally important, the party who questions the prudence of an expenditure must do so by presenting evidence or referring to material of which the Commission may take official notice. *Minnesota Power & Light Company*, Opinion No. 86, 11 FERC ¶ 61,312 (1980). When a group of wholesale customers failed to present evidence that a project was imprudent, the Commission did not have to make findings on the project's prudence. The court affirmed the Commission's decision to balance can-

**Order on Motion, FERC Doc. No. ER81-612-000**

celled plant losses between ratepayers and investors as a rational compromise under which ratepayers will pay for expenditures made, and investors will not receive a return on their investment in the plant. *Union Electric Company v. FERC, supra.*

City has not come forward with any evidence to demonstrate that CEI's decision to participate in the construction and operation of the four nuclear generating units was improper or imprudent, that the costs incurred by the company were unreasonable, or that the proposal to amortize the cancelled plant losses as a cost of service component over a 10-year period is unjust or contrary to sound regulatory ratemaking principles. City's opposition to the cost of service treatment of plant losses is based entirely on argument.

The Staff's motion for summary disposition of the issue of CEI's inclusion in cost of service amortized losses associated with abandoned nuclear generating units is granted. During the hearing on the reserved issue, the parties will mark and offer in evidence all relevant and material prepared testimony on the abandonment losses issue, which will be received without oral direct testimony or cross-examination. The parties will have an opportunity to argue any pertinent points of law on brief.

#### IV

Staff's motion for summary disposition of the cost of service issues states that the ADITC rate base adjustment will increase CEI's cost of service by \$195,000 which will negate City's claim that revenues generated by the rate proposal will exceed cost of service by \$137,000. Therefore, Staff asserts, the proposed rate increase is cost justified, legally and factually, so the scope of the proceeding should be narrowed to the issue of whether the minimum billing demand provision is justified.

**Order on Motion, FERC Doc. No. ER81-612-000**

There is pending a motion filed by City to revise its cost of service study to eliminate \$87,453 for nuclear plant losses. This adjustment, according to City, will increase its computation for excess revenues claimed by CEI from \$136,754 to \$215,171. The motion will be granted by separate order and City's cost of service will be adjusted accordingly.

CEI concurs with Staff that there are no issues of material fact as to the lawfulness of the proposed rate increase. It also asserts that, since all cost of service studies now show the rate increase to be cost justified, there is no need to proceed with litigation on these issues. As to the minimum billing provisions, which it claims that City mischaracterizes as a demand ratchet, CEI argues that prepared testimony to be offered by Staff and the company support the position that a 70% minimum billing provision is reasonable and City has not presented any testimony or exhibits to seriously rebut these conclusions. In any case, CEI submits that the offer of settlement which it has filed in this proceeding will, if approved by the Commission, dispose of all issues, including the minimum billing provision, without further litigation. Thus, according to CEI, the Staff motion to reserve the minimum billing issue for an oral hearing should be denied.

City opposes restricting the scope of the litigation phase of this case to the minimum billing provisions. City contends that the end result test in the *Hope* case, *supra*, is not the only relevant and material factor to be considered in determining the justness and reasonableness of a rate proposal. This approach to ratemaking has been rejected by the courts for twenty-five years. The rule now is that the fairness, reasonableness and non-confiscatory characters of a rate can only be determined by examining and testing the propriety of the elements comprising the rate. *Mississippi River Fuel Corp. v. F.P.C.*, 163 F.2d 433 (D.C.

**Order on Motion, FERC Doc. No. ER81-612-000**

Cir. 1947); *Memphis Light, Gas and Water Division v. F.P.C.*, 504 F.2d 225 (D.C. Cir. 1974); *Columbia Gas Transmission Corp. v. FERC*, 628 F.2d 578 (D.C. Cir. 1979); and *Public Service Commission of the State of New York v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980). Furthermore, City states there are issues of fact to be heard in a trial-type hearing such as cash working capital, rate of return, discriminatory rates and amortization of losses connected with abandoned plants, which are recurring in nature and should be decided in this proceeding. Finally, City maintains there is no justification to assume Staff's position to be meritorious and to deny City a right to a hearing on contested issues, particularly the demand ratchet and the discriminatory rates issues, both of which have a substantial impact on City and in regard to which it is entitled to present testimony and to cross-examine witnesses.

Like the other parties to this proceeding, City was directed to submit a statement of position on all issues it intended to litigate and to indicate the dollar amount in dispute on each issue. City's statement of position included the three issues covered by Staff's motions for summary disposition, cash working capital, the minimum billing demand, discriminatory rates and rate of return.

City places the dollar amounts in dispute on the ADITC issue and amortization of plant closing losses at \$233,000 and \$96,000. These are the two issues that critically affect City's cost of service study and ultimately the justness and reasonableness of CEI's proposed rate level.

If City's own calculations are used to revise its cost of service study to conform with the provisions of section 46(f) of the IRC, Commission policy and judicial precedents on the ADITC and cancelled plant loss issues, City's computed allowable revenue requirements will increase from \$2,100,738 to \$2,429,738, or \$192,246 more than

CEI's claimed revenues. Stated somewhat differently, even if City prevails on the cash working capital and rate of return issues, the only other cost of service components it has placed in issue, the sum of the elements comprising the rate support the conclusion that the rate increase is cost justified.

The character of a rate is determined by its relationship to the sum of the components. *Mississippi River Fuel Corp. v. F.P.C.*, *supra*. As defined by the court, the components are operating expenses, depreciation and rate of return. If the rate yields no more than the sum of these items, it is considered fair, reasonable and non-confiscatory. The "end result" in a rate case is the ability of the rate to meet the sum of the costs required to conduct operations in fairness to the consumer and the company. *Ibid*.

As previously noted, after adjustments to City's cost of service, to comply with statutory requirements and controlling precedents, all three cost of service studies show that the revenue increase claimed by CEI is necessary to cover operating expenses, taxes, depreciation, cost of capital and other allowable cost components. There is no factual dispute among the parties regarding computational techniques or accounting procedures used to give effect to such cost components as ADITC balances, interest expense deductions for tax purposes and the amortization of losses associated with plant cancellations. These matters involve either questions of policy or the interpretation and application of legal precedents.

So the cost of service end result in the circumstances at hand produces a fair, reasonable and non-confiscatory rate that will generate sufficient revenues to meet all proper expenses. *Mississippi River Fuel Corp. v. F.P.C.*, *supra*.

**Order on Motion, FERC Doc. No. ER81-612-000**

The other cases cited by City to refute the end result principle are inapposite. In the *Memphis* case, *supra*, the court was concerned with whether a Commission decision to consider exhaustion of natural resources in establishing a depreciation rate without determining the useful life of depreciable property was based on reasoned inferences drawn from substantial evidence of record. The *Columbia Gas Transmission* case dealt with rate design issues and a Commission decision to change a formula used by a natural gas pipeline for 25 years without what the Court considered an adequate or reasoned explanation. The *New York Public Service Commission* case involved a Commission decision to order a natural gas pipeline to use a new technique for cost allocation over a system divided into three sales zones and whether the decision was based on substantial evidence and complied with the procedural requirements of the Natural Gas Act.

None of these cases stands for the proposition that a party has a right to litigate every contested component in a cost of service study in circumstances where, as here, the end result justifies the fare level claimed by the utility. Such a finding would merely encourage needless litigation on issues with minimal or no decisional significance and expose all parties to burdensome and unnecessary expenditures in time and money. Recently, the Commission reaffirmed a long-standing principle that no party is deprived of procedural due process where there is no requirement to conduct a full evidentiary hearing because there are no material facts in dispute. *Yankee Atomic Electric Company*, Docket No. ER80-569, and *Public Service Company of New Hampshire*, Docket No. ER80-570, Commission order issued on February 11, 1982.

The motion for summary disposition of cost of service issues is granted.

## V

An examination of the prepared testimony and exhibits to be offered in evidence by the parties reveals that there are material issues of fact in dispute with respect to the minimum billing provision issue. It is well-settled that fundamental principles of due process entitle a party to a full evidentiary hearing on any issues where material facts are controverted so that it will have an opportunity to offer in evidence testimony and exhibits and to cross-examine opposing witnesses.

It is therefore found and concluded that the minimum billing provision issue should be reserved for a trial type hearing and that the litigation phase of this proceeding will be limited to that issue.

It is so ordered.

/s/ ALEXANDER N. ARGERAKIS

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Alexander N. Argerakis  
Administrative Law Judge

**FEDERAL ENERGY REGULATORY COMMISSION**  
**Washington, D. C. 20426**

In reply refer to: OCA-AS

JUL 7 1982

Mr. Charles Chopp  
Controller  
The Cleveland Electric  
Illuminating Company  
Post Office Box 5000  
Illuminating Building  
55 Public Square  
Cleveland, Ohio 44101

Dear Mr. Chopp:

We have reviewed your letter dated May 18, 1982, in which you requested authorization to adjust the amount deferred in Account 182, Extraordinary Property Losses, and to revise the amortization period of such amount with respect to your Company's loss from the termination of proposed units at the Davis-Besse Nuclear Power Station and Erie Nuclear Plant. In our letter dated April 14, 1980, we authorized your Company to amortize the termination costs over a ten-year period commencing with the effective date of rates which provided for recovery of the loss.

In your letter, it was disclosed that:

1. In July 1981, the Ohio Supreme Court (OSC) ruled that the Public Utilities Commission of Ohio (PUCO) did not have the authority under Ohio Law to authorize the Company to recover such termination costs through rates as an operating expense.

2. In October 1981, the PUCO directed your Company to suspend amortization with the unamortized balances to remain in Account 182 pending further direction by the PUCO.

3. In January 1982, the United States Supreme Court refused on procedural grounds to hear the Company's appeal of the Ohio Supreme Court ruling.

4. A PUCO rate order, Case No. 81-146-EL-AIR, dated March 17, 1982, included in the return on common stock equity a factor recognizing the added risk being incurred by common stock owners as a result of the decision of the Ohio Supreme Court in July 1981, and also authorized the Company to amortize the unrecovered investment balances assignable to terminated units over an appropriate period of time, not to exceed 15 years.

5. The Company adopted an amortization period of 15 years commencing April 1982, with respect to the unamortized balance in Account 182 at April 30, 1982, amounting to \$55,302,933.

It appears from the information available that the company is specifically denied by law from recovery of the costs through rates related to the termination of the proposed nuclear units. The addition factor included in the return on common equity allowed by the PUCO in your most recent rate order is not directly related to the amortization of cost of any specific termination but appears under the circumstances to be compensation to the common equity holders for additional risk.

We believe, based on the above, that the costs of termination now deferred have been found not to be an asset by definition and, therefore, should be charged against income in the current period. We believe that to record such costs as an asset and amortize the costs would result

in financial statements that are misleading because the statements would not reflect the economic realities of the rate process.

While we note that the accounting for the termination costs was approved by the PUCO, your request for approval of a new 15-year amortization period and related amounts to be recorded in Account 182 is hereby denied. Your Company is directed to write the unamortized costs, amounting to \$55,302,933, off to Account 435, Extraordinary Deductions, upon receipt of this letter.

Sincerely yours,

L. H. DRENNAN, JR.  
*Chief Accountant*

## OHIO STATUTES

## OHIO REVISED CODE

§ 4905.13 System of accounts for public utilities.  
(GC § 499-14)

The public utilities commission may establish a system of accounts to be kept by public utilities or railroads, including municipally owned or operated public utilities, or may classify said public utilities or railroads and establish a system of accounts for each class, and may prescribe the manner in which such accounts shall be kept. Such system shall, when practicable, conform to the system prescribed by the department of taxation. The commission may prescribe the forms of accounts, records, and memorandums to be kept by such public utilities or railroads, including the accounts, records, and memorandums of the movement of traffic as well as of the receipts and expenditure of moneys, and any other forms, records, and memorandums which are necessary to carry out Chapters 4901., 4903., 4905., 4907., 4909., 4921., 4923., and 4925. of the Revised Code. The system of accounts established by the commission and the forms of accounts, records, and memorandums prescribed by it shall not be inconsistent, in the case of corporations subject to the act of congress entitled "An act to regulate commerce" approved February 4, 1887, and the acts amendatory thereof and supplementary thereto, with the systems and forms established for such corporations by the interstate commerce commission. This section does not affect the power of the public utilities commission to prescribe forms of accounts, records, and memorandums covering information in addition to that required by the interstate commerce commission. The public utilities commission may, after hearing had upon its own motion or complaint, prescribe by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. Where the public utilities commission

## Ohio Statutes

has prescribed the forms of accounts, records, or memorandums to be kept by any public utility or railroad for any of its business, no such public utility or railroad shall keep any accounts, records, or memorandums for such business other than those so prescribed, or those prescribed by or under the authority of any other state or of the United States, except such accounts, records or memorandums as are explanatory of and supplemental to the accounts, records, or memorandums prescribed by the commission. The commission shall at all times have access to all accounts kept by such public utilities or railroads and may designate any of its officers or employees to inspect and examine any such accounts. The auditor or other chief accounting officer of any such public utility or railroad shall keep such accounts and make the reports provided for in sections 4905.14 and 4907.13 of the Revised Code. Any auditor or chief accounting officer who fails to comply with this section shall be subject to the penalty provided for in division (C) of section 4905.99 of the Revised Code. The attorney general shall enforce such section upon request of the public utilities commission by mandamus or other appropriate proceedings.

**HISTORY:** GC § 499-14; 103 v 804(812), § 27. Eff 10-1-53. Analogous to former GC § 614-10.

### **§ 4905.18 Depreciation account. (GC § 614-49)**

Every public utility shall carry a proper and adequate depreciation or deferred maintenance account, whenever the public utilities commission, after investigation, determines that a depreciation account can be reasonably required. The commission shall ascertain, determine, and prescribe what are proper and adequate charges for depreciation of the several classes of property for each public utility. The public utility commission shall require every

**Ohio Statutes**

telephone company to carry a proper and adequate depreciation or deferred maintenance account and shall ascertain, determine, and prescribe what are proper and adequate charges in each exchange area of such company. The charge for depreciation shall be such as will provide the amount required over the cost and expense of maintenance to keep the property of the public utility in a state of efficiency corresponding to the progress of the art or industry. The commission may prescribe such changes in such charges for depreciation as it finds necessary.

HISTORY: GC § 614-49; 102 v 549(563), § 51; 125 v 613(614). Eff 10-26-53.

**§ 4905.20 Abandonment of facilities.**

No railroad as defined in section 4907.02 of the Revised Code, operating any railroad in this state, and no public utility as defined in section 4905.02 of the Revised Code furnishing service or facilities within this state, shall abandon or be required to abandon or withdraw any main track or depot of a railroad, or main pipe line, gas line, telegraph line, telephone toll line, electric light line, water line, sewer line, steam pipe line, or any portion thereof, pumping station, generating plant, power station, sewage treatment plant, or service station of a public utility, or the service rendered thereby, which has once been laid, constructed, opened, and used for public business, nor shall any such facility be closed for traffic or service thereon, therein, or thereover except as provided in section 4905.21 of the Revised Code. Any railroad or public utility violating this section shall forfeit and pay into the state treasury not less than one hundred dollars, nor more than one thousand dollars, and shall be subject to all other legal and equitable remedies for the enforcement of this section and section 4905.21 of the Revised Code.

HISTORY: GC § 504-2; 107 v 525; 108 v Pt I 372; 129 v. 501. Eff 9-19-61.

**Ohio Statutes****§ 4905.22 Service and facilities required; unreasonable charge prohibited.** (GC §§ 614-12, 614-13)

Every public utility shall furnish necessary and adequate service and facilities, and every public utility shall furnish and provide with respect to its business such instrumentalities and facilities, as are adequate and in all respects just and reasonable. All charges made or demanded for any service rendered, or to be rendered, shall be just, reasonable, and not more than the charges allowed by law or by order of the public utilities commission, and no unjust or unreasonable charges shall be made or demanded for, or in connection with, any service, or in excess of that allowed by law or by order of the commission.

HISTORY: GC §§ 614-12, 614-13; 102 v 549(553), § 14; 102 v 549(554), § 15. Eff 10-1-53.

**§ 4909.15 Fixation of reasonable rate.**

(A) The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges shall determine:

(1) The valuation as of the date certain of the property of the public utility used and useful in rendering the public utility service for which rates are to be fixed and determined. The valuation so determined shall be the total value as set forth in division (J) of section 4909.05 of the Revised Code, and a reasonable allowance for materials and supplies and cash working capital, as determined by the public utilities commission. The commission may, in its discretion, permit a reasonable allowance for construction work in progress but, in no event, may any allowance for construction work in progress be made by the commission until it has determined, after a physical inspection, that the particular construction project is at least seventy-five percent complete.

**Ohio Statutes**

(2) A fair and reasonable rate of return to the utility on the valuation as determined in division (A)(1) of this section;

(3) The dollar annual return to which the utility is entitled by applying the fair and reasonable rate of return as determined under division (A)(2) of this section to the valuation of the utility determined under division (A)(1) of this section;

(4) The cost to the utility of rendering the public utility service for the test period less the total of any interest on cash or credit refunds paid, pursuant to section 4909.42 of the Revised Code, by the utility during the test period. Federal, state, and local taxes imposed on or measured by net income may, in the discretion of the commission, be computed by the normalization method of accounting, provided the utility maintains accounting reserves that reflect differences between taxes actually payable and taxes on a normalized basis, provided that no determination as to the treatment in the rate making process of such taxes shall be made that will result in loss of any tax depreciation or other tax benefit to which the utility would otherwise be entitled, and further provided that such tax benefit as redounds to the utility as a result of such a computation may not be retained by the company, used to fund any dividend, or utilized for any purpose other than the defrayal of the operating expenses of the utility and the defrayal of the expenses of the utility in connection with construction work.

(B) The public utilities commission shall compute the gross annual revenues to which the utility is entitled by adding the dollar amount of return under division (A)(3) of this section to the cost of rendering the public utility service for the test period under division (A)(4) of this section.

(C) The test period, unless otherwise ordered by the public utilities commission, shall be the twelve-month

**Ohio Statutes**

period beginning six months prior to the date the application is filed and ending six months subsequent to that date. The revenues and expenses of the utility shall be determined during the test period. The date certain shall be not later than the date of filing.

(D) When the public utilities commission is of the opinion, after hearing and after making the determinations under divisions (A) and (B) of this section, that any rate, fare, charge, toll, rental, schedule, classification, or service, or any joint rate, fare, charge, toll, rental, schedule, classification, or service rendered, charged, demanded, exacted, or proposed to be rendered, charged, demanded, or exacted, is, or will be, unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law, that the service is, or will be, inadequate, or that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable, the commission shall:

(1) With due regard among other things, to the value of all property of the public utility actually used and useful for the convenience of the public as determined under division (A)(1) of this section, excluding from such value the value of any franchise or right to own, operate, or enjoy the same in excess of the amount, exclusive of any tax or annual charge, actually paid to any political subdivision of the state or county, as the consideration for the grant of such franchise or right, and excluding any value added to such property by reason of a monopoly or merger, with due regard in determining the dollar annual return under division (A)(3) of this section to the necessity of making reservation out of the income for surplus, depreciation, and contingencies, and;

(2) With due regard to all such other matters as are proper, according to the facts in each case,

(a) Including a fair and reasonable rate of return determined by the commission with reference to a cost of

**Ohio Statutes**

debt equal to the actual embedded cost of debt of such public utility,

(b) But not including the portion of any periodic rental or use payments, representing that cost of property which is included in the valuation report under divisions (F) and (G) of section 4909.05 of the Revised Code, fix and determine the just and reasonable rate, fare, charge, toll, rental, or service to be rendered, charged, demanded, exacted, or collected for the performance or rendition of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one. After such determination and order no change in the rate, fare, toll, charge, rental, schedule, classification, or service, shall be made, rendered, charged, demanded, exacted, or changed by such utility without the order of the commission, and any other rate, fare, toll, charge, rental, classification, or service is prohibited.

(E) Upon application of any person or any public utility, and after notice to the parties in interest and opportunity to be heard as provided in Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code for other hearings, has been given, the commission may rescind, alter, or amend an order fixing any rate, fare, toll, charge, rental, classification, or service, or any other order made by the commission. Certified copies of such orders shall be served and take effect as provided for original orders.

In no event shall an allowance for construction work in progress under division (A)(1) of this section exceed twenty percent of the total valuation as stated in such division not including such allowance.

\*HISTORY: 137 v H 230 (Eff 10-9-77); 138 v H 657 (Eff 9-24-79); 138 v H 736. Eff 10-16-80.

**Ohio Statutes****OHIO ADMINISTRATIVE CODE****§ 4901:1-9-05 Uniform classification of accounts for electric utilities: FPC, 1961**

The system of accounts and records, identified and designated as "Uniform System of Accounts Prescribed for Public Utilities and Licensees, effective January 1, 1961," as adopted by the Federal Power Commission, is adopted by this Commission effective as of January 1, 1961, for electric light companies operating within the State of Ohio which are subject to the jurisdiction of the Federal Power Commission except to the extent that the provisions of said Uniform System of Accounts are inconsistent in any way with the outstanding orders of this Commission pertaining to the accounting treatment to be followed with respect to emergency facilities and the Federal income tax results thereof and with respect to accelerated depreciation and the Federal income tax results thereof. This Commission reserves to itself the right to require the creation and maintenance of such additional accounts as may hereafter be prescribed, to cover the accounting procedure of such electric light companies operating in the State of Ohio. Each such public utility shall carry on its books, in addition to such additional accounts as may hereafter be prescribed by this Commission, the accounts and records prescribed in said Uniform System of Accounts effective January 1, 1961, for a public utility of its class, and shall accordingly keep such accounts in accordance with the requirements, definitions and instructions contained and set forth in said uniform system of accounts except to the extent that the provisions of said Uniform System of Accounts are inconsistent in any way with the outstanding orders of this Commission pertaining to the accounting treatment to be followed with respect to emergency facilities and the Federal income tax results thereof and with respect to accelerated depreciation and

**Ohio Statutes**

the Federal income tax results thereof in the stead and in lieu of the accounts and records prescribed by the provisions of rule 4901:1-9-02.

**HISTORY:** Eff. 1-20-63

Former Rule 25.05

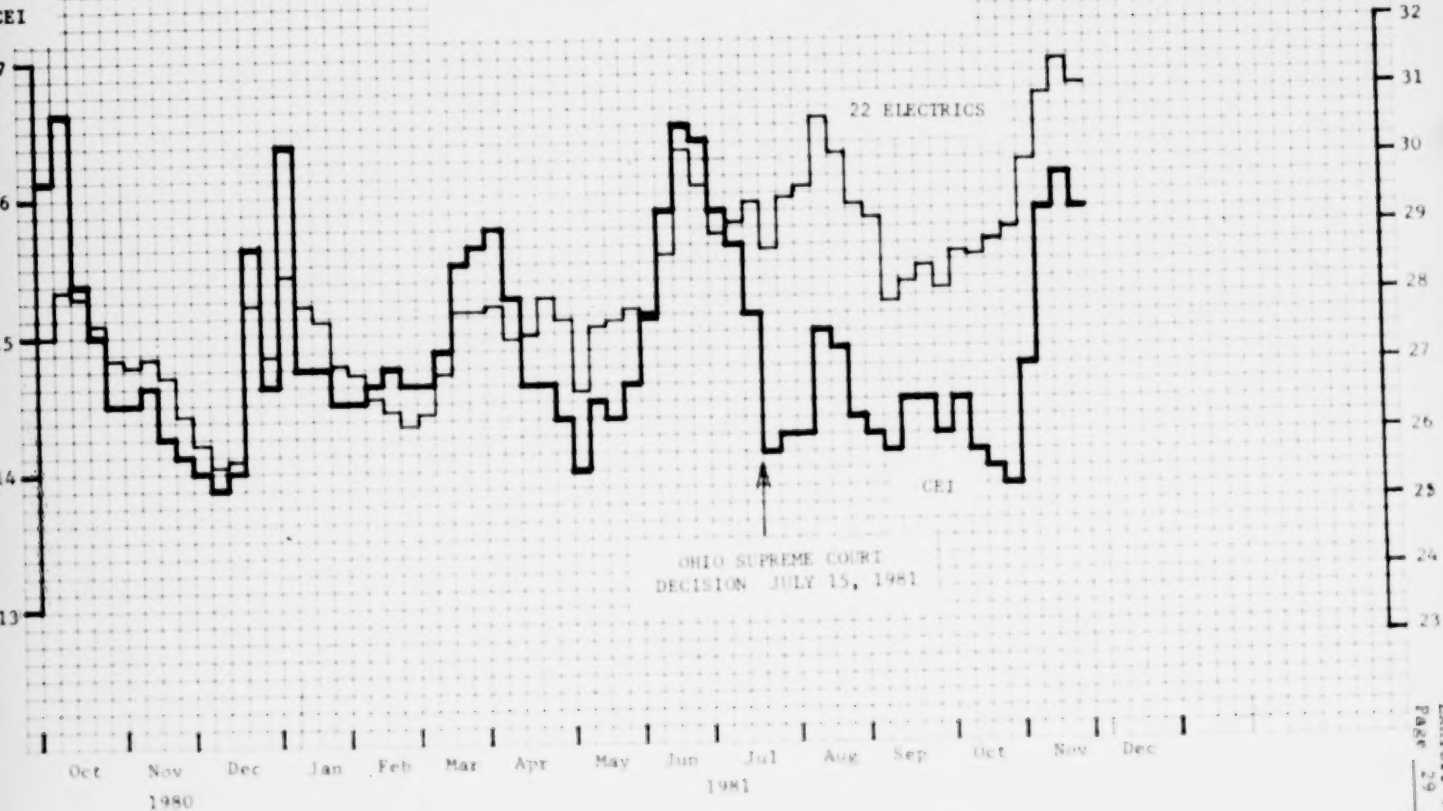
# APPENDIX #7

CEI CLOSING PRICES

VS.

STANDARD & POORS 22 ELECTRICS

22 ELECTRICS



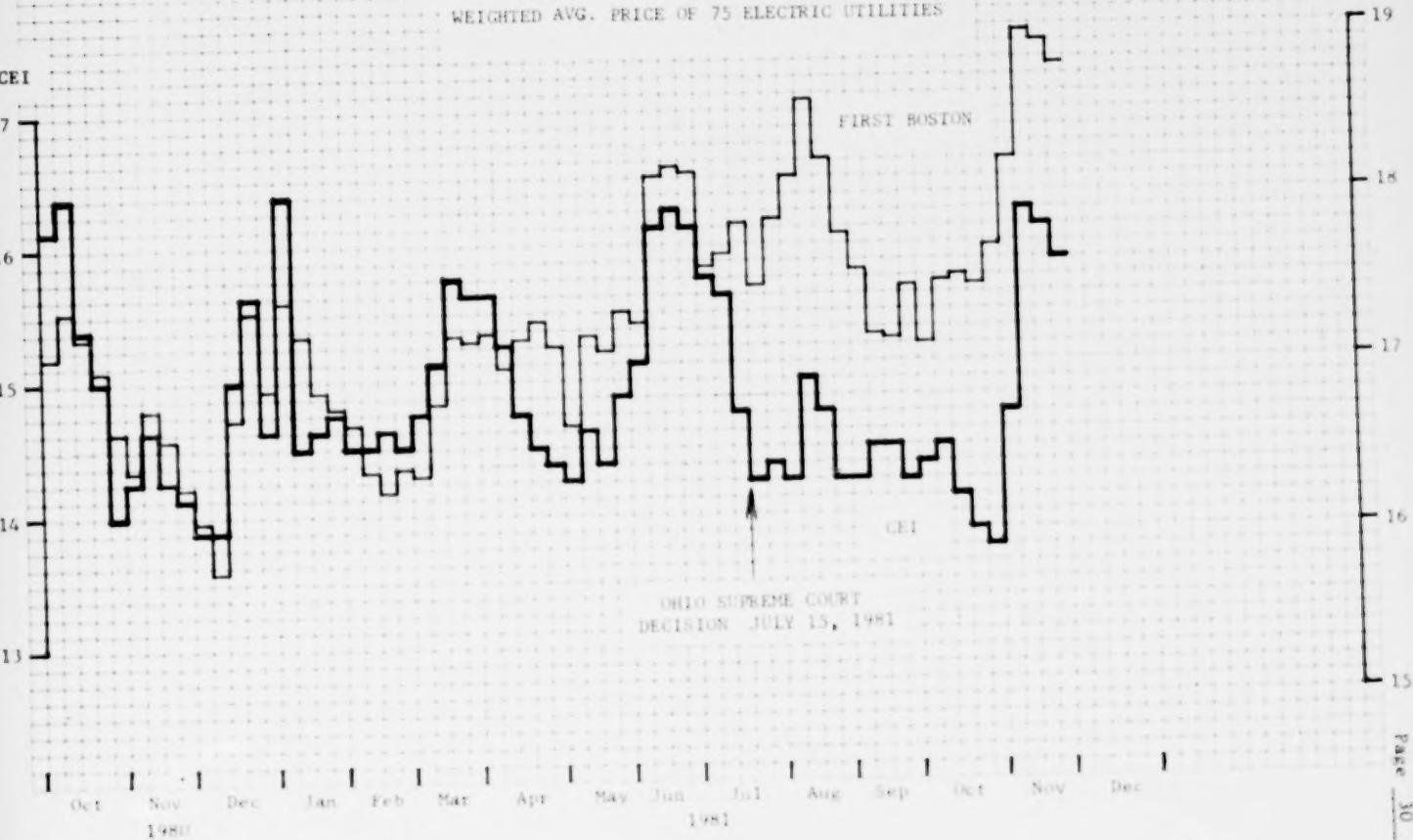
APPENDIX #8  
CEI CLOSING PRICE

VS.

FIRST BOSTON ELECTRIC UTILITY INDEX  
WEIGHTED AVG. PRICE OF 75 ELECTRIC UTILITIES

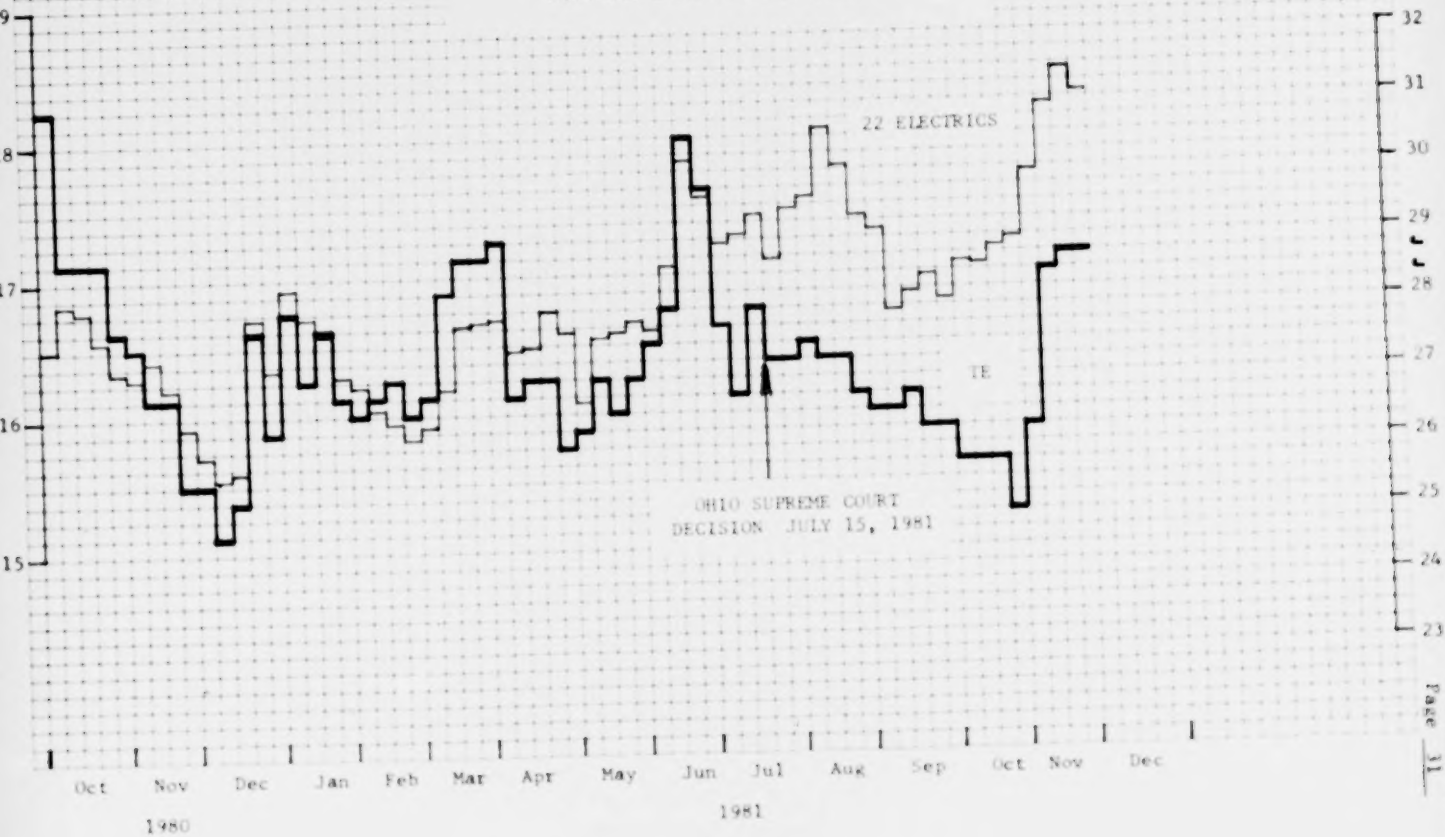
CEI

FIRST BOSTON



OHIO SUPREME COURT  
DECISION JULY 15, 1981

APPENDIX #9  
 TOLEDO EDISON CLOSING PRICE  
 VS.  
 STANDARD & POORS 22 ELECTRICS



# APPENDIX #12

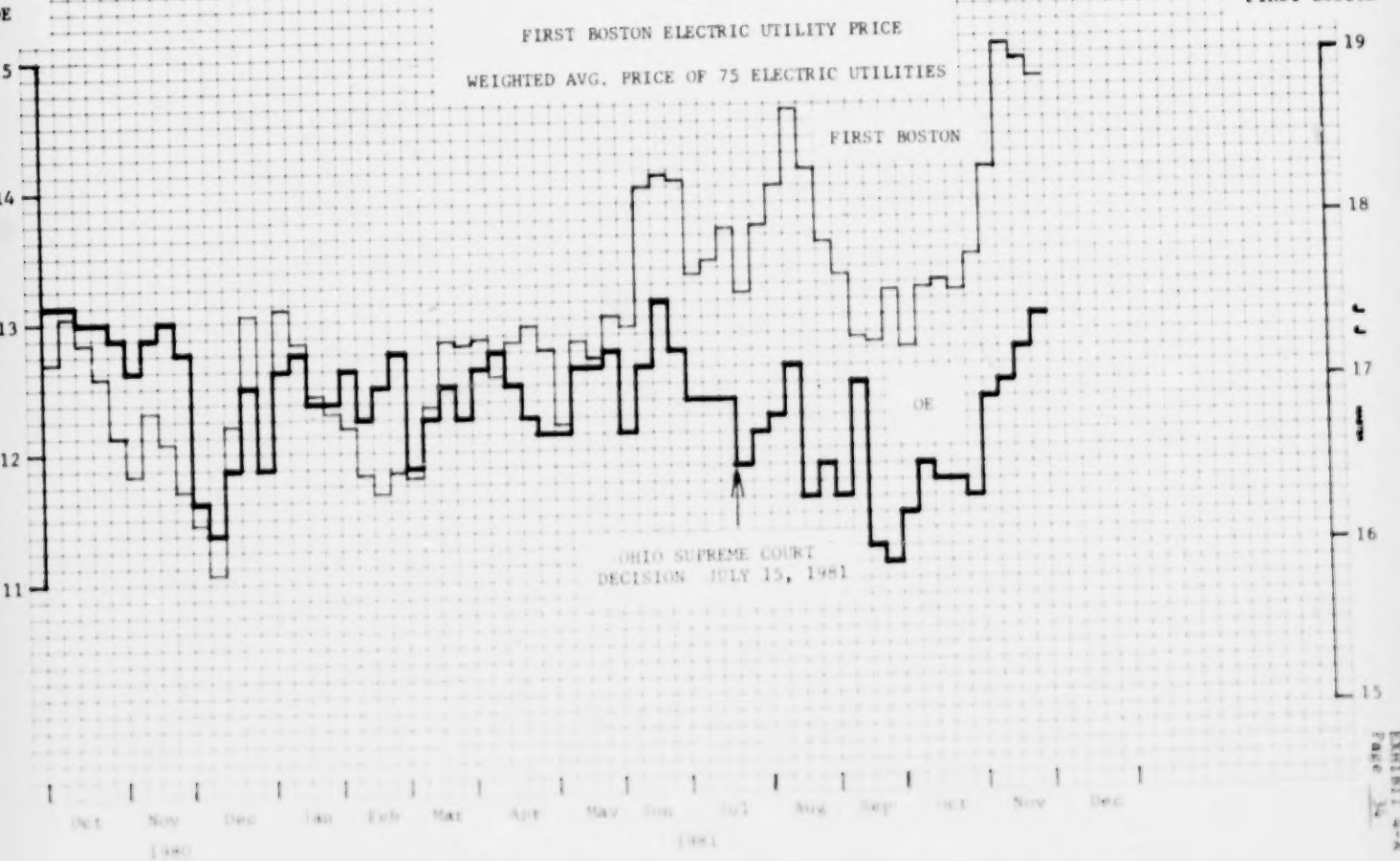
OHIO EDISON CLOSING PRICE

VS.

FIRST BOSTON

FIRST BOSTON ELECTRIC UTILITY PRICE

WEIGHTED AVG. PRICE OF 75 ELECTRIC UTILITIES



APPENDIX #11

TOLEDO EDISON CLOSING PRICE

VS.

FIRST BOSTON ELECTRIC UTILITY PRICE

WEIGHTED AVG. PRICE OF 75 ELECTRIC UTILITIES

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APPENDIX #10  
OHIO EDISON CLOSING PRICE  
VS.  
STANDARD & POORS 22 ELECTRICS

22 ELECTRICS

